# FORM 10−K

## SAKS INC − sks

### Filed: April 03, 2007 (period: February 03, 2007)

Annual report which provides a comprehensive overview of the company for the past year

# Table of Contents

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10−K

**(Mark One)**

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For Fiscal Year Ended: February 3, 2007**

**or**

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from to**

**Commission File Number: 1−13113**

# SAKS INCORPORATED

**(Exact Name of Registrant as Specified in Its Charter)**

| | |
|---|---|
| **Tennessee**<br>**(State of Incorporation)** | **62−0331040**<br>**(I.R.S. Employer Identification Number)** |
| **750 Lakeshore Parkway** | |
| **Birmingham, Alabama**<br>**(Address of Principal Executive Offices)** | **35211**<br>**(Zip Code)** |

**Registrant's telephone number, including area code: (205) 940−4000**

**Securities Registered Pursuant to Section 12 (b) of the Act:**

| Title of each class | Name of Each Exchange on which registered |
|---|---|
| **Common Shares, par value $0.10 and** | **New York Stock Exchange** |
| **Preferred Stock Purchase Rights** | |

**Securities Registered Pursuant to Section 12 (g) of the Act: None**

Indicate by check mark if the registrant is a well−known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

Indicate by check mark if the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S−K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10−K or any amendment to this Form 10−K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non−accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b−2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non−accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b−2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the voting stock held by non−affiliates of the registrant as of July 29, 2006 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately $2,176,158,343.

As of March 15, 2007, the number of shares of the registrant's Common Stock outstanding was 141,395,144.

**DOCUMENTS INCORPORATED BY REFERENCE**

Applicable portions of the Saks Incorporated Proxy Statement for the 2007 Annual Meeting of Shareholders to be held on June 6, 2007 are incorporated by reference into Part III of this Form 10−K.

# TABLE OF CONTENTS

# PART I

## Item 1. Business.

### *General*

The operations of Saks Incorporated, a Tennessee corporation first incorporated in 1919, and its subsidiaries (together the “Company”) consist of Saks Fifth Avenue (“SFA”), Off Fifth and Club Libby Lu (“CLL”). Previously, the Company also operated Saks Department Store Group (“SDSG”), which consisted of Proffitt’s and McRae’s (“Proffitt’s”) (sold to Belk, Inc. (“Belk”) in July 2005), the Northern Department Store Group (“NDSG”) (operated under the nameplates of Bergner’s, Boston Store, Carson Pirie Scott, Herberger’s and Younkers and sold to The Bon−Ton Stores, Inc. (“Bon−Ton”) in March 2006), and Parisian (sold to Belk in October 2006). The sold businesses are presented as discontinued operations in the consolidated statements of income and the consolidated statements of cash flows for the current and prior year periods and are discussed below at “Discontinued Operations.”

SFA stores are principally free−standing stores in exclusive shopping destinations or anchor stores in upscale regional malls, and the stores typically offer a wide assortment of distinctive luxury fashion apparel, shoes, accessories, jewelry, cosmetics and gifts. Customers may also purchase SFA products by catalog or online at saks.com. Off Fifth is intended to be the premier luxury off−price retailer in the United States and provides an outlet for the sale of end−of−season clearance merchandise. Off Fifth stores are primarily located in upscale mixed−use and off−price centers and offer luxury apparel, shoes, accessories, cosmetics and decorative home furnishings, targeting the value−conscious customer. CLL consists of mall−based specialty stores, targeting girls aged 4−12 years old. As of February 3, 2007, Saks operated 54 SFA stores with 6.0 million square feet, 49 Off 5th units with 1.4 million square feet, and 87 CLL specialty stores, which includes 62 standalone stores and 25 store−in−stores in the former SDSG businesses, with 0.1 million square feet. CLL revenues totaled approximately $52 million in 2006.

Merchandising, sales promotion, and store operating support functions are conducted in New York, New York for SFA and Off Fifth and in Chicago, Illinois for Club Libby Lu. The majority of back office sales support functions for the Company, such as accounting, credit card administration, store planning and information technology, are located in the Company’s operations center in Jackson, Mississippi or in the SFA corporate offices in New York City. Certain back office and executive functions historically have been located in Birmingham, Alabama, but the Company intends that by the end of the second fiscal quarter of 2007 these functions will be consolidated into either the Jackson or New York City facilities.

### *Discontinued Operations*

*Sale of Assets*

On July 5, 2005, Belk acquired from the Company for $622.7 million in cash substantially all of the assets directly involved in the Company’s Proffitt’s business operations, plus the assumption of approximately $1 million in capitalized lease obligations and the assumption of certain other ordinary course liabilities associated with the acquired assets. The assets sold included the real and personal property and inventory associated with 22 Proffitt’s stores and 25 McRae’s stores that generated fiscal 2004 revenues of approximately $784 million. The Company realized a net gain of $155.5 million on the sale.

On March 6, 2006, the Company sold to Bon−Ton all outstanding equity interests of certain of the Company’s subsidiaries that owned NDSG, either directly or indirectly. The consideration received consisted of approximately $1.12 billion in cash (reduced as described below based on changes in working capital), plus the assumption by Bon−Ton of approximately $35 million of unfunded benefit liabilities and approximately $35 million of capital leases. A working capital adjustment based on working capital as of the effective time of the transaction reduced the amount of cash proceeds by approximately $75 million resulting in net cash proceeds to the Company of approximately $1.04 billion. The disposition included NDSG's operations consisting of, among other things, the following: the real and personal property, operating leases and inventory associated with 142 NDSG units (31 Carson Pirie Scott stores, 14 Bergner's stores, 10 Boston Store stores, 40 Herberger's stores, and 47 Younkers stores), the administrative/headquarters facilities in Milwaukee, Wisconsin, and distribution centers located in Rockford, Illinois, Naperville, Illinois, Green Bay, Wisconsin, and Ankeny, Iowa. NDSG generated fiscal 2005 revenues of approximately $2.2 billion. The Company realized a net gain of $204.7 million on the sale.

On October 2, 2006, the Company sold to Belk all of the outstanding equity interests of the Company's subsidiaries that conducted the Parisian specialty department store business ("Parisian"). The consideration received consisted of $285.0 million in cash (increased in accordance with a working capital adjustment described below). In addition, Belk reimbursed the Company at closing for $6.7 million in capital expenditures incurred in connection with the construction of four new Parisian stores. Belk also paid the Company a premium associated with the purchase of accounts and accounts receivable from Household Bank (SB), N.A. (now known as HSBC Bank Nevada, N.A., "HSBC"), in the amount of $2.3 million. A working capital adjustment based on working capital as of the effective time of the transaction increased the amount of cash proceeds by $14.2 million resulting in net cash proceeds of $308.2 million. The disposition included Parisian's operations consisting of, among other things, the following: real and personal property, operating leases and inventory associated with 38 Parisian stores (which generated fiscal 2005 revenues of approximately $740 million), an administrative/headquarters facility in Birmingham, Alabama and a distribution center located in Steele, Alabama. The Company realized a net loss of $12.8 million on the sale.

***Merchandising***

SFA stores carry luxury merchandise from both core vendors and new and emerging designers. SFA has key relationships with the leading American and European fashion houses, including Giorgio Armani, Chanel, Gucci, Prada, St. John, Zegna, Theory, Juicy Couture, David Yurman, Hugo Boss, Elie Tahari, Ralph Lauren, Akris and Burberry, among many others.

The Company has developed a knowledge of each of its trade areas and customer bases for its SFA and Off 5th stores. This knowledge is gained through use of on−line merchandise information, store visits by senior management and merchandising personnel, and frequent communication between merchandising staff and store management. The Company strives to tailor each store's merchandise assortment to the characteristics of its trade areas and customer bases and to the lifestyle needs of its local customers.

Certain departments in the Company's SFA stores are leased to independent companies in order to provide high quality service and merchandise where specialization and expertise are critical. The leased departments are designed to complement the Company's owned merchandising departments. The principal leased departments in the SFA stores are furs and certain designer handbags. The terms of the lease agreements typically are between one and seven years and may require the lessee to pay for a portion of the fixtures and provide its own employees. Management regularly evaluates the performance of the leased departments and requires compliance with established customer service guidelines.

For the year ended February 3, 2007, SFA's percentages of owned sales (exclusive of sales generated by leased departments) by major merchandise category were as follows:

| | |
|---|---|
| Women's Apparel | 37.7% |
| Cosmetics | 16.3% |
| Men's Apparel | 13.9% |
| Accessories | 19.3% |
| Shoes | 8.5% |
| Home and gifts | 1.0% |
| Children's Apparel | 0.5% |
| Intimate Apparel | 1.8% |
| Outerwear | 1.0% |
| Total | 100.0% |

***Purchasing and Distribution***

The Company purchases merchandise from many vendors. Management monitors profitability and sales history with most vendors and believes it has alternative sources available for each category of merchandise it purchases. Management believes it maintains good relationships with its vendors.

The Company has two distribution facilities serving its stores. Refer to "Item 2. Properties" for a listing of these facilities.

The Company's distribution facilities operate on a modern warehouse management system that leverages EDI (electronic data interchange) technology in conjunction with high−speed automated conveyor systems in order to receive and distribute merchandise as economically as possible to the Company's stores. Many of the Company's vendors also utilize EDI technology which permits merchandise to be 'cross docked' from the receiving department to the shipping department, with very little handling. The distribution centers also use efficient radio frequency hand−held devices to scan barcodes on merchandise that is too large or fragile for the conveyor system. The warehouse management system is interfaced to the Company's mainframe to execute 'booking' of the merchandise to the stores and to pass the appropriate records to accounting for invoice payment and reconciliation.

***Information Technology***

Company management believes that technological investments are necessary to support its business strategies, and, as a result, the Company is continually upgrading its information systems to improve efficiency and productivity. The Company has recently completed an upgrade of its merchandising planning and allocation systems and expects to install new point−of−sale equipment and software with enhanced clienteling capabilities throughout 2007 and 2008.

The Company's information systems provide information deemed necessary for management operating decisions, cost management programs, and customer service enhancements. Individual data processing systems include point−of−sale and sales reporting, purchase order management, receiving, merchandise planning and control, payroll, human resources, general ledger, credit card administration, and accounts payable systems. Bar code ticketing is used, and scanning is utilized at point−of−sale terminals. Information is made available on−line to merchandising staff and store management on a timely basis.

The use of EDI technology allows the Company to speed the flow of information and merchandise in an attempt to capitalize on emerging sales trends, maximize inventory turnover, and minimize out−of−stock conditions. EDI technology includes an advance shipping notice system (“ASN”). The ASN system identifies discrepancies between merchandise that is ready to be shipped from a supplier’s warehouse and that which was ordered from the supplier. This early identification provides the Company with a window of time to resolve any discrepancies in order to speed merchandise through the distribution facilities and into its stores.

***Marketing***

For the SFA stores, marketing principally emphasizes the latest fashion trends in luxury merchandise and primarily utilizes direct mail advertising, supplemented with national and local marketing efforts. To promote its image as the primary source of luxury goods in its trade areas, SFA sponsors numerous fashion shows and in−store special events highlighting the designers represented in the SFA stores. SFA also participates in “cause−related” marketing. This includes special in−store events and related advertising designed to drive store traffic, while raising funds for charitable causes and organizations such as women’s cancer research. In−house advertising and sales promotion staffs produce the Company’s advertising.

For SFA, the Company utilizes data captured through the use of proprietary credit cards offered by HSBC to develop advertising and promotional events targeted at specific customers who have purchasing patterns for certain brands, departments, and store locations.

***Proprietary Credit Cards***

HSBC offers proprietary credit card accounts to the Company’s customers. Pursuant to a program agreement with a term of ten years expiring in 2013, HSBC establishes and owns proprietary credit card accounts for the Company’s customers, retains the benefits and risks associated with the ownership of the accounts, receives the finance charge income and incurs the bad debts associated with those accounts. Pursuant to a servicing agreement with a ten−year term expiring in 2013, the Company continues to provide key customer service functions, including new account opening, transaction authorization, billing adjustments and customer inquiries, and receives compensation from HSBC for the provision of these services.

In September of 2006 the company entered into agreements with HSBC and MasterCard to issue a co−branded MasterCard to new and existing proprietary credit card customers. Under this program, qualifying customers are issued a SFA and MasterCard branded credit card that functions as a traditional proprietary credit card when used at any SFA or Off 5th store and at Saks Direct or as a MasterCard when used at any unaffiliated location that accepts MasterCard. HSBC establishes and owns the co−brand accounts, retains the benefits and sales associated with the ownership of the accounts, receives the finance charge and other income from the accounts, and incurs the bad−debts associated with the accounts.

Historically, proprietary credit card holders have shopped more frequently with the Company and purchased more merchandise than customers who pay with cash or third−party credit cards. The Company also makes frequent use of the names and addresses of the proprietary credit card holders in its direct marketing efforts.

The Company seeks to expand the number and use of the proprietary credit cards by, among other things, providing monetary incentives to sales associates to open new credit accounts, which generally can be opened while a customer is visiting one of the Company’s stores. Customers who open accounts are entitled to a discount on the first day’s purchases. Customers using the proprietary credit card are eligible for the SaksFirst loyalty program that rewards customers for spending on their proprietary charge cards. Additionally, co−brand card customers earn similar SaksFirst points for purchases made at unaffiliated locations. Increased spending will result an increased rate of reward. Rewards come in the form of electronic gift cards that are redeemable on future purchases. In addition, members of the loyalty program are eligible for other rewards and benefits including special shopping events and travel discounts.

There are more than 0.8 million proprietary credit accounts that have been active within the prior twelve months, and approximately 46% of the Company's 2006 sales were transacted on HSBC's proprietary credit cards.

***Trademarks and Service Marks***

The Company owns many trademarks and service marks including, but not limited to, "Saks Fifth Avenue," "SFA," "S5A," "The Fifth Avenue Club," "SAKSFIRST," "SFA Signature," "SFA Classic," "SFA Sport." "Off 5th," and "Club Libby Lu." Management believes its trademarks and service marks are important and that the loss of certain of its trademarks or trade names, particularly the store nameplates, could have a material adverse effect on the Company. Many of the Company's trademarks and service marks are registered in the United States Patent and Trademark Office. The terms of these registrations are generally ten years, and they are renewable for additional ten−year periods indefinitely so long as the marks are in use at the time of renewal. The Company is not aware of any claims of infringement or other challenges to its right to use its marks that would have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

***Reliance on Fifth Avenue Store***

The Company's Flagship SFA store located on Fifth Avenue in New York City accounted for approximately 20% of total Company sales in 2006 and plays a significant role in creating awareness for the Saks Fifth Avenue brand name.

***Customer Service***

The Company believes that good customer service contributes to increased store visits and purchases by its customers.

The Company's goal is to deliver an inviting, customer−focused shopping experience to each customer. At SFA and Off Fifth, the Company seeks to enable its customers to discover both accessible and high−end fashion in a warm, welcoming environment, guided by knowledgeable sales associates. Compensation for sales associates generally is a pay−for−performance program, based upon productivity. Sales associates undergo extensive service, selling, and product−knowledge training and are encouraged to maintain frequent, personal contact with their customers. Sales associates are encouraged to keep detailed customer records, send personalized thank−you notes and routinely communicate with customers to advise them of new merchandise offerings and special promotions. Typical SFA stores also provide comfortable seating areas and refreshments throughout the store, and most SFA stores offer a complimentary personal shopping service called "The Fifth Avenue Club."

***Seasonality***

The Company's business, like that of many retailers, is subject to seasonal influences, with a significant portion of its sales and net income realized during the second half of the fiscal year, which includes the holiday selling season. Generally, more than 30% of the Company's sales are generated during the fourth quarter, and a large portion of its operating income is generated during the fall season.

### *Competition*

The retail business is highly competitive. The Company’s stores primarily compete with several national and regional department stores, specialty apparel stores, designer boutiques, outlet stores, and mail−order and electronic commerce retailers, some of which have greater financial and other resources than those of the Company. Management believes that its knowledge of its trade areas and customer base, combined with providing a high level of customer service and a broad selection of quality fashion merchandise at appropriate prices in good store locations, provides the opportunity for a competitive advantage.

### *Associates*

As of March 15, 2007, the Company employed approximately 16,000 associates, of which approximately 23% were employed on a part−time basis. The Company hires additional temporary associates and increases the hours of part−time associates during seasonal peak selling periods. Less than one percent of the Company’s associates are covered by collective bargaining agreements. The Company considers its relations with its associates to be good.

### *Website Access to Information*

The Company provides access free of charge through the Company’s website, *www.saksincorporated.com,* to the Company’s annual report on Form 10−K, quarterly reports on Form 10−Q, current reports on Form 8−K and all amendments to those reports as soon as reasonably practicable after the reports are electronically filed with or furnished to the Securities and Exchange Commission (“SEC”).

### *Certifications*

The Company has filed the certification of its Chief Executive Officer with the New York Stock Exchange (“NYSE”) in fiscal 2006 as required pursuant to Section 303A.12(a) of the NYSE Listed Company Manual, and the Company has filed the Sarbanes−Oxley Section 302 certifications of its principal executive officer and principal financial officer with the SEC, which are attached hereto as Exhibits 31.1 and 31.2.

## Item 1A. Risk Factors

The following are certain risk factors that affect the Company’s business, financial condition, results of operations and cash flows, some of which are beyond the Company’s control. These risk factors should be considered in connection with evaluating the forward−looking statements contained in this Annual Report on Form 10−K. The risks and uncertainties described below are not the only ones facing the Company. If any of the events described below were to actually occur, the Company’s business, financial condition, results of operations or cash flows could be adversely affected and results could differ materially from expected and historical results.

***Poor economic conditions affect consumer spending and may significantly harm the Company’s business.***

The retail industry is continuously subject to domestic and international economic trends. The success of the Company’s business depends to a significant extent upon the level of consumer spending. A number of factors affect the level of consumer spending on merchandise that the Company offers, including, among other things:

- General economic, industry and weather conditions;
- High crude oil prices, that affect gasoline and heating oil prices;
- The level of consumer debt;

- Interest rates;
- Tax rates and policies;
- War, terrorism and other hostilities; and
- Consumer confidence in future economic conditions.

Changes in consumer confidence and fluctuations in financial markets can influence cyclical trends, particularly in the luxury sector. The merchandise the Company sells generally consists of discretionary items. Reduced consumer confidence and spending may result in reduced demand for discretionary items and may force the Company to take significant inventory markdowns. Reduced demand may also require increased selling and promotional expenses.

Additionally, a number of the Company's stores are in tourist markets, including the flagship SFA New York store. A downturn in economic conditions or other events such as terrorist activity could impact travel and thus negatively affect the results of operations for stores located within these tourist markets. Increases in transportation and fuel costs, the financial condition of the airline industry and its impact on air travel and sustained recessionary periods in the U.S. and internationally could also unfavorably impact results of the stores located within these tourist markets.

***The Company's business and results of operations are subject to a broad range of uncertainties arising out of world events.***

The Company's business and results of operations are subject to uncertainties arising out of world events, especially as these events may affect U.S. tourism. These uncertainties may include a global economic slowdown, changes in consumer spending or travel, an increase in gasoline and commodity prices, epidemics and the economic consequences of natural disasters, military action or terrorist activity (including threats of terrorist activity). Any future events arising as a result of terrorist activity, natural disasters or other world events may have a material impact on the Company's business, its ability to source products, results of operations and financial condition in the future.

***The Company's business and results of operations may be adversely affected by weather conditions and natural disasters.***

The Company's business is adversely affected by unseasonable weather conditions. Periods of unseasonably warm weather in the fall or winter or unseasonably cold or wet weather in the spring or summer affect consumer apparel purchases and could have a material adverse effect on the Company's results of operations and financial condition. Additionally, natural disasters such as hurricanes, tornadoes, earthquakes, etc. may adversely affect the Company's results of operations and financial condition.

***The Company's business is intensely competitive and increased or new competition could have a material adverse effect on the Company.***

The retail industry is intensely competitive. As a retailer offering a broad selection of luxury fashion apparel, shoes, accessories, jewelry, cosmetics and gift items, the Company currently competes against a diverse group of retailers, including e−commerce retailers, which sell, among other products, products similar to those of the Company. The Company also competes in particular markets with a substantial number of retailers that specialize in one or more types of products that the Company sells. Following the sale of the Company's SDSG businesses, the Company has become less diversified and is now reliant on its luxury retail business. A number of different competitive factors could have a material adverse effect on the Company's business, results of operations and financial condition including:

- Increased operational efficiencies of competitors;
- Competitive pricing strategies, including deep discount pricing by a broad range of retailers during periods of poor consumer confidence or economic instability;
- Expansion by existing competitors;
- Entry by new competitors into markets in which the Company currently operates; and
- Adoption by existing competitors of innovative retail sales methods.

The Company may not be able to continue to compete successfully with its existing or new competitors, or be assured that prolonged periods of deep discount pricing by its competitors will not have a material adverse effect on the Company's business.

***The Company is dependent on its relationships with certain designers, vendors and other sources of merchandise.***

The Company's relationships with established and emerging designers are a key factor in its position as a retailer of high−fashion merchandise, and a substantial portion of its revenues are attributable to its sales of designer merchandise. Many of the Company's key vendors limit the number of retail channels they use to sell their merchandise and competition among luxury retailers to obtain and sell these goods is intense. The Company's relationships with its designers have been a significant contributor to its past success. The Company has no guaranteed supply arrangements with its principal merchandising sources. Accordingly, there can be no assurance that such sources will continue to meet the Company's quality, style and volume requirements. Moreover, nearly all of the brands of the Company's top designers are sold by competing retailers, and many of these top designers also have their own dedicated retail stores. If one or more of the Company's top designers were to cease providing the Company with adequate supplies of merchandise or, conversely, were to increase sales of merchandise through its own stores or to the stores of other competitors, the Company's business could be adversely affected. In addition, any decline in the popularity or quality of any of the Company's designer brands could adversely affect its business.

***The Company faces risks associated with consumer preferences and fashion trends.***

Changes in consumer preferences or consumer interest could have a material adverse effect on the Company's business. In addition, fashion trends could materially impact sales. Success in the retail business depends, in part, on the Company's ability to anticipate consumer preferences. Early order commitments often are made far in advance of consumer acceptance. If the Company fails to anticipate accurately and respond to consumer preferences, it could experience lower sales, excess inventories and lower profit margins, any of which could have a material adverse effect on the Company's results of operations and financial condition.

***The Company faces a number of risks in opening new stores.***

Management remains confident regarding the future prospects for SFA and Off Fifth. SFA has a highly recognized brand name in luxury retailing, a top quality real estate portfolio led by the New York flagship store, and strong vendor relationships. Management plans to capitalize on the growth prospects and competitive dynamics of the luxury sector. As part of its growth strategy, the Company could potentially increase the total number of stores, which may include opening new stores in both new and existing markets. The Company may not be able to operate any new stores profitably. Further, new stores may not achieve operating results similar to those of its existing stores. The success of any future store openings will depend upon numerous factors, many of which are beyond the Company’s control, including the following:

- The ability of management to adequately analyze and identify suitable markets and individual store sites within those markets;
- The ability to attract appropriate vendors;
- The competition for suitable store sites;
- The ability to negotiate favorable lease terms with landlords;
- The availability of employees to staff new stores and the Company’s ability to hire, train, motivate and retain store personnel; and
- The ability to attract customers and generate sales sufficient to operate new stores profitably.

In future years, the Company may enter into additional markets. These markets may have different competitive conditions, consumer trends and discretionary spending patterns than its existing markets, which may cause new stores in these markets to be less successful than stores in existing markets.

***The loss of, or disruption in, the Company’s centralized distribution centers would have a material adverse effect on the Company’s business and operations.***

The Company depends on the orderly operation of the receiving and distribution process, which depends, in turn, on adherence to shipping schedules and effective management of distribution centers. Although the Company believes that its receiving and distribution process is efficient, unforeseen disruptions in operations due to fire, hurricanes or other catastrophic events, labor disagreements or shipping problems, may result in delays in the delivery of merchandise to the Company’s stores.

Additionally, freight cost is impacted by changes in fuel prices. Fuel prices affect freight cost both on inbound freight from vendors to the distribution centers and outbound freight from the distribution centers to the Company’s stores.

Although the Company maintains business interruption and property insurance, management cannot be assured that the Company’s insurance coverage will be sufficient, or that insurance proceeds will be timely paid to the Company, if any of the distribution centers are shut down for any reason.

***The Company is dependent on external funding sources, which may not make available sufficient funds when the Company needs them.***

The Company, like other retailers, relies on external funding sources to finance a portion of its operations and growth. Management currently believes that the Company’s cash flow from operations and funds available under its revolving credit facility will satisfy its capital requirements for the next 12 months. The Company’s ability to obtain additional financing is dependent upon its future operating performance, general economic and competitive conditions and financial, business and other factors, many of which the Company cannot control.

***The Company believes that its previously disclosed internal investigations, and related inquiries by the SEC and the Office of the United States Attorney for the Southern District of New York, adversely affected the Company’s results of operations for its 2005 fiscal year, which adverse effect could continue.***

The Company understands that the inquiries by the SEC and the Office of the United States Attorney for the Southern District of New York are continuing. The Company understands that these inquiries were initiated as a

result of previously disclosed internal investigations by the Company. The Company believes that the publicly disclosed findings of the internal investigations, and the restatement by the Company of previously published financial information as reflected in its Annual Report on Form 10−K for 2004, adversely affected the Company's ability, at least temporarily, to collect vender allowances from some SFA merchandise vendors and may have damaged, at least temporarily, SFA's reputation among SFA's merchandise vendors and the investment community generally. These adverse effects could continue to negatively impact the future results of SFA's operations and the market price of the Company's common stock. The Company's internal investigations also resulted in disciplinary actions being taken against a number of SFA associates. These disciplinary actions eliminated the employment positions of several experienced merchandising associates and adversely affected associate morale and focus on SFA's business. The adverse effects described in this paragraph, which the Company believes are diminishing with the passage of time, could continue.

The inquiries by the SEC and the Office of the United States Attorney for the Southern District of New York could result in enforcement action or actions being taken against the Company, including the imposition of fines and penalties that could adversely affect the Company's financial condition and results of operations. During 2005, the Company incurred significantly larger legal and related fees, compared to prior periods, as a result of the investigations. These investigation−related legal and other fees were substantially lower in 2006 than in 2005. The Company expects that it will continue to incur legal fees with respect to the investigations, the end and outcome of which the Company cannot predict.

**Item 1B. Unresolved Staff Comments**

None.

**Item 1C. Executive Officers of the Registrant.**

The name, age, and position held with the Company for each of the executive officers of the Company are set forth below.

| Name | Age | Position |
|---|---|---|
| R. Brad Martin | 55 | Chairman of the Board of Directors; Director |
| Stephen I. Sadove | 55 | Chief Executive Officer; Director |
| James A. Coggin | 64 | President and Chief Administrative Officer |
| Douglas E. Coltharp | 45 | Executive Vice President and Chief Financial Officer |
| Ronald L. Frasch | 57 | President and Chief Merchandising Officer |
| Charles J. Hansen | 59 | Executive Vice President and General Counsel |
| Christine A. Morena | 51 | Executive Vice President of Human Resources |
| Kevin G. Wills | 41 | Executive Vice President of Finance and Chief Accounting Officer |
| Julia A. Bentley | 48 | Senior Vice President of Investor Relations and Communications; Corporate Secretary |
| Carolyn R. Biggs | 59 | Executive Vice President of Stores, Store Visual, Planning and Construction |
| Denise Incandela | 42 | President, Saks Direct and Group Senior Vice President |
| Thomas G. Matthews | 52 | Group Senior Vice President, Asset Protection and Store Operations, Ethics and Compliance |
| Marc J. Metrick | 33 | Group Senior Vice President and Chief Strategy Officer |
| Terron E. Schaefer | 62 | Senior Vice President of Marketing |
| Robert T. Wallstrom | 41 | President, Off Fifth and Group Senior Vice President |

R. Brad Martin has served as a Director since 1984 and became Chairman of the Board in February 1987. He served as Chief Executive Officer from July 1989 until January 2006.

Stephen I. Sadove was named Chief Executive Officer of the Company in January 2006. He joined the Company in January 2002 as Vice Chairman and assumed the additional responsibility of Chief Operating Officer in March 2004. Mr. Sadove served as Senior Vice President of Bristol−Myers Squibb and President of Bristol−Myers Squibb Worldwide Beauty Care from 1996 until January 2002. From 1991 until 1996, Mr. Sadove held various other executive positions with Bristol−Myers Squibb. From 1975 until 1991, Mr. Sadove held various positions of increasing responsibility with General Foods USA.

James A. Coggin was named President and Chief Administrative Officer of the Company in November 1998. Mr. Coggin served as President and Chief Operating Officer of the Company from March 1995 to November 1998 and served as Executive Vice President and Chief Administrative Officer of the Company from March 1994 to March 1995. From 1971 to March 1994, Mr. Coggin served in various management and executive positions with McRae’s, Inc. Mr. Coggin will retire from the Company on May 4, 2007.

Douglas E. Coltharp joined the Company in November 1996 as Executive Vice President and Chief Financial Officer. From 1987 to November 1996, Mr. Coltharp was employed by NationsBank (currently Bank of America), where he held a variety of positions including the post of Senior Vice President of Corporate Finance.

Ronald L. Frasch, age 57, was named President and Chief Merchandising Officer of the Company in February 2007. He held the post of Vice Chairman and Chief Merchant of Saks Fifth Avenue from November 2004 until January 2007. He joined Saks Fifth Avenue in January 2004 and served in a non−executive capacity through November 2004. Frasch served as Chairman and Chief Executive Officer of Neiman Marcus Group's Bergdorf Goodman from April 2000 until January 2004. Prior to that, he held merchandising and executive posts with other companies including GFT USA, Escada USA, Neiman Marcus, and Saks Fifth Avenue.

Charles J. Hansen was promoted to Executive Vice President and General Counsel of the Company in September 2003. He served in several capacities in the Company's Law Department from February 1998 to September 2003, most recently as Senior Vice President and Deputy General Counsel. Prior to that, he served in various legal capacities with Carson Pirie Scott & Co. and its predecessors, including the post of Vice President, General Counsel, and Secretary. Prior to that, he was an attorney with Baxter International, Inc. and Shearman & Sterling.

Christine A. Morena joined the Company in January 2007 as Executive Vice President of Human Resources. Ms. Morena spent her career from 1976 through 2006 with AT&T Inc., where she held various positions of increasing responsibility. Morena most recently served as Senior Vice President of Human Resources for AT&T Corporation, a subsidiary of AT&T Inc.

Kevin G. Wills was appointed to Executive Vice President of Finance and Chief Accounting Officer, the Company's principal financial officer, in May 2005. He joined the Company in September 1997 and has served in the following capacities: Vice President of Financial Reporting from September 1997 to August 1998; Senior Vice President of Strategic Planning from September 1998 to August 1999; Senior Vice President of Planning and Administration of SDSG from September 1999 to January 2003; and Executive Vice President of Operations for Parisian from February 2003 to May 2005. Prior to joining the Company, Mr. Wills was Vice President and Controller for the Tennessee Valley Authority and before that, he was an audit manager with Coopers and Lybrand (now PricewaterhouseCoopers, LLP).

Julia A. Bentley has served as Senior Vice President of Investor Relations and Communications and Corporate Secretary of the Company since September 1997. Ms. Bentley joined the Company in 1987 and has held various financial positions, including Chief Financial Officer. Prior to joining the Company she was an audit manager with Ernst & Young.

Carolyn R. Biggs was named Executive Vice President of Stores, Store Visual, Planning and Construction effective February 2007. Ms. Biggs joined the Company in July 1993 and has held various leadership positions since that time, including Senior Vice President and Director of Stores for SFA. Prior to the Company she was General Manager of I. Magnin from 1988 to 1993 and held various merchandising positions for Bullocks from 1973 to 1988.

Denise Incandela was elevated to President, Saks Direct and Group Senior Vice President of the Company in February 2007. Ms. Incandela joined the Company in July 1999 and has held various leadership positions since that time, including Senior Vice President of Saks Direct. Prior to the Company she was a senior consultant with McKinsey & Company.

Thomas G. Matthews was named Chief Ethics and Compliance Officer in February 2007. Matthews assumed this role as well as continued his role as Group Senior Vice President Operations—Asset Projection—Logistics, which he has held since 2005. Matthews joined the Company in 1993 as Vice President—Loss Prevention. Prior to the Company he served as Senior Vice President—Loss Prevention for Ann Taylor, Inc. from 1989 until 1992 and in various loss prevention positions for Lord & Taylor from 1976 to 1989.

Marc J. Metrick was named Group Senior Vice President and Chief Strategy Officer of the Company in February 2007. Metrick joined the Company in June 1995 as an executive trainee. Since June 1997, Metrick has served in various planning roles, including Senior Vice President — Merchandise Planning and Vice President — Strategic Planning.

Terron E. Schaefer, joined the Company in March 2004 as Senior Vice President of Marketing. Prior to joining the Company, he served as Co−Founder and CEO of style365.com. Schaefer also served as Senior Vice President, Marketing — Worldwide Retail for Warner Brothers from 1995 to 1998, and between 1988 to 1995 his retail experience included leadership positions in marketing at Macy's West, Galerias Preciados, and Harrods. Schaefer also served in various leadership positions in marketing at Bloomingdale's and William Filene and Sons. He began his marketing career with Doyle Dane Bernbach where he rose to Vice President, International.

Robert T. Wallstrom was named President, Off Fifth and Group Senior Vice President of the Company in February 2007. Wallstrom joined the Company in June 1995 and has held various leadership positions since that time, including Senior Vice President and General Manager of the SFA flagship store in New York City. Prior to the Company he was a store manager for Macy's/Bullocks.

The Company is consolidating its executive functions into the existing SFA corporate offices in New York City from Birmingham, Alabama. This consolidation is expected to be completed in the first half of 2007. Messrs. Coltharp, Hansen, and Wills each notified the Company that, for personal reasons, they would not relocate their place of employment from Birmingham, Alabama to New York City, and, as a consequence, each intends to resign effective May 4, 2007.

**Item 2. Properties.**

The Company currently operates two principal distribution facilities as follows:

| Company Stores Served | Location of Facility | Square Feet | Owned/Leased |
|---|---|---|---|
| Saks Fifth Avenue, Off 5th and Saks Direct | Aberdeen, Maryland | 514,000 | Leased |
| Saks Fifth Avenue and Off 5th | Ontario, California | 120,000 | Leased |

The Company's principal administrative offices are as follows:

| Office | Location of Facility | Square Feet | Owned/Leased |
|---|---|---|---|
| Corporate Administration | Birmingham, Alabama | 48,000 | Leased |
| Corporate Operations Center | Jackson, Mississippi | 272,000 | Owned |
| Saks Fifth Avenue corporate offices | New York, New York | 298,000 | Leased |
| CLL support offices | Chicago, Illinois | 46,000 | Leased |

The Company is consolidating its corporate administration functions into the existing SFA corporate offices in New York City from Birmingham, Alabama. This consolidation is expected to be completed in the first half of 2007.

The following table sets forth information about the Company's stores as of March 31, 2007. The majority of the Company's SFA stores are owned while all of the Company's Off Fifth stores are leased. Store leases generally require the Company to pay a fixed minimum rent and a variable amount based on a percentage of annual sales at that location. Generally, the Company is responsible under its store leases for a portion of mall promotion and common area maintenance expenses and for certain utility, property tax, and insurance expenses. Typically, the Company contributes to common mall maintenance and is responsible for property tax and insurance expenses at its owned locations. Generally, store leases have primary terms ranging from 20 to 30 years and include renewal options ranging from 5 to 20 years. Off 5th leases typically have shorter terms.

| Store Name | Owned Locations Number Of Units | Owned Locations Gross Square Feet (in mil.) | Leased Locations Number Of Units | Leased Locations Gross Square Feet (in mil.) | Total Number Of Units | Total Gross Square Feet (in mil.) | Primary Locations |
|---|---|---|---|---|---|---|---|
| Saks Fifth Avenue | 31 | 4.1 | 23 | 1.9 | 54 | 6.0 | National |
| Off 5th | — | 0.0 | 49 | 1.4 | 49 | 1.4 | National |
| **Total** | **31** | **4.1** | **72** | **3.3** | **103** | **7.4** | |

In addition to the stores listed above, the Company also operated 89 CLL specialty stores, which includes 64 standalone stores and 25 store−in−stores in the former SDSG businesses, at March 31, 2007. These stores are leased and are typically one to two thousand square feet of space in regional malls.

## Item 3. Legal Proceedings.

### *Investigations*

At management's request, the Audit Committee of the Company's Board of Directors conducted an internal investigation in 2004 and 2005. In 2004, the Company informed the SEC of the Audit Committee's internal investigation. Thereafter, the Company was informed by the SEC that it issued a formal order of private investigation. Thereafter, the Company was informed that the Office of the United States Attorney for the Southern District of New York had instituted an inquiry. The Company believes that the subject of these inquiries includes one or more of the matters that were the subject of the investigations by the Audit Committee and possibly includes related matters. The results of the Audit Committee's internal investigation have been previously disclosed by the Company. The Company has responded to subpoenas and other requests for information from the SEC, including a subpoena requesting information concerning, among other items, the Company's allocation to vendors of a portion of markdown costs associated with certain of the Company's customer loyalty and other promotional activities, as well as information concerning markdowns, earnings, and other financial data for 1999−2003. The Company is continuing to fully cooperate with the SEC and the Office of the United States Attorney, whose investigations the Company understands are continuing.

### *Vendor Litigation*

On May 17, 2005, International Design Concepts, LLC ("IDC") commenced litigation against the Company in the United States District Court for the Southern District of New York raising various claims, including breach of contract, fraud and unjust enrichment. The suit alleges that from 1996 to 2003 the Company improperly took chargebacks and deductions for vendor markdowns, which resulted in IDC going out of business. The suit seeks damages in the amount of the unauthorized chargebacks and deductions. IDC filed a second amended complaint on June 14, 2005 asserting an additional claim for damages under the Uniform Commercial Code for vendor compliance chargebacks.

On October 25, 2005 the Chapter 7 trustee for the bankruptcy estate of Kleinert's Inc. filed a complaint against the Company and several of its subsidiaries in the United States Bankruptcy Court for the Southern District of New York. In its initial complaint the plaintiff, as assignee, alleged breach of contract, fraud, and unjust enrichment, among other causes of action, and seeks compensatory and punitive damages due to the Company's assessment of alleged improper chargebacks against Kleinert's Inc. totaling approximately $4 million which wrongful acts the plaintiff alleges caused the insolvency and bankruptcy of Kleinert's Inc. On August 15, 2006 the plaintiff, as assignee, filed an amended complaint in which it asserts the following claims, among others: (1) defendants applied improper chargebacks to the accounts payable of Kleinert's, which led to the extreme financial distress and Kleinert's eventual bankruptcy and Kleinert's incurred liabilities and lost profits of at least $100 million and plaintiff requests punitive damages of no less than $50 million (conversion claim);

(2) from 1998− 2003 defendants charged back an amount not less than $4 million to Kleinert's and these chargebacks improperly benefited the defendants, and plaintiff requests $4 million on this claim (unjust enrichment claim); (3) defendants falsely represented that its $4 million in chargebacks were proper and Kleinert's reliance on defendants' misrepresentations caused Kleinert's to lose not less than $4 million and caused it to file for bankruptcy resulting in liabilities and lost profits of $100 million, and plaintiff requests punitive damages of no less than $50 million (fraud claim); (4) defendants wrongfully charged back at least $4 million and these unwarranted chargebacks assisted Kleinert's officers and directors in booking fictitious sales revenue and accounts receivable and perpetrating a fraud on Kleinert's lenders in excess of $25 million, and plaintiff requests punitive damages of no less than $50 million (fraud claim); (5) defendants used dishonest, improper and unfair means in conducting business with Kleinert's and interfered with Kleinert's relationship with its lenders (tortious interference with prospective economic advantage claim); (6) defendants assisted officers of Kleinert's in breaching their fiduciary duties to Kleinert's and to its creditors by falsifying borrowing base certificates given to the lenders, and defendants knew that their improper chargeback scheme was assisting these breaches of fiduciary duty by Kleinert's officers, with respect to which plaintiff requests $100 million plus $50 million in punitive damages (aiding and abetting breach of fiduciary duty claim); (7) defendants knew that their improper chargeback scheme was assisting the perpetration of fraud by Kleinert's officers, and plaintiff requests $100 million plus $50 million in punitive damages (aiding and abetting fraud claim); and (8) various fraudulent conveyance claims with respect to which plaintiff requests damages of $4 million.

On December 8, 2005 Adamson Apparel, Inc. filed a purported class action lawsuit against the Company in the United States District Court for the Northern District of Alabama. In its complaint the plaintiff asserts breach of contract claims and alleges that the Company improperly assessed chargebacks, timely payment discounts, and deductions for merchandise returns against members of the plaintiff class. The lawsuit seeks compensatory and incidental damages and restitution.

***Shareholders' Derivative Suits***

On April 29, 2005, a shareholder derivative action was filed in the Circuit Court of Jefferson County, Alabama for the putative benefit of the Company against the members of the Board of Directors and certain executive officers alleging breach of their fiduciary duties in failing to correct or prevent problems with the Company's accounting and internal control practices and procedures, among other allegations. Two similar shareholder derivative actions were filed on May 4, 2005 and May 5, 2005, respectively, in the Chancery Court of Davidson County, Tennessee. All three actions generally sought unspecified damages and disgorgement by the executive officers named in the complaints of cash and equity compensation received by them. Two of the lawsuits were dismissed with prejudice in late 2006 and the third lawsuit was dismissed with prejudice in early 2007. In connection with the dismissals no payments were made to the plaintiffs or their counsel by or on behalf of the Company or any of the individual defendants and none of the Company and the individual defendants incurred or agreed to undertake any obligation or liability to the plaintiffs.

***Other***

The Company is involved in several legal proceedings arising from its normal business activities and has accruals for losses where appropriate. Management believes that none of these legal proceedings will have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

***Market Information***

The Company's common stock trades on the New York Stock Exchange ("NYSE") under the symbol SKS. The prices in the table below represent the high and low sales prices for the stock as reported by the NYSE.

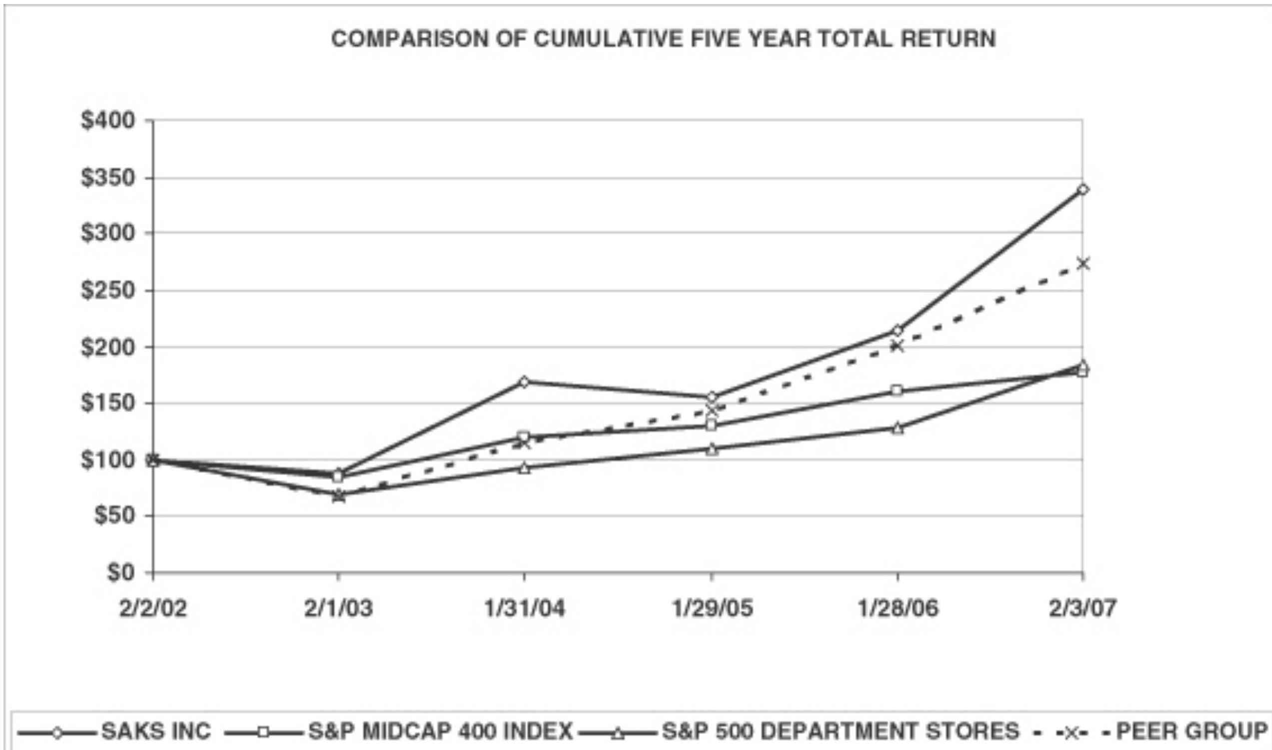
| | Year Ended February 3, 2007 | | Year Ended January 28, 2006 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First Quarter | $20.48 | $18.11 | $19.27 | $13.82 |
| Second Quarter | $20.59 | $15.04 | $21.40 | $16.46 |
| Third Quarter | $19.64 | $14.10 | $24.58 | $15.73 |
| Fourth Quarter | $21.00 | $16.46 | $19.48 | $15.81 |

***Holders***

As of March 15, 2007, there were approximately 2,384 shareholders of record of the Company's common stock.

***Performance Graph***

The following graph and table compare cumulative total shareholder return among the Company, the S&P Midcap 400 Index, the S&P Retail Stores — Department Index, and a Retail Peer Group Index (weighted by market capitalization and consisting of the Company; Dillard's, Inc.; Federated Department Stores, Inc.; Nordstrom, Inc.; J.C. Penney Company, Inc.; and, through the fiscal year ended January 29, 2005, The May Department Stores Company and The Neiman Marcus Group, Inc., both of which were acquired in 2005 and are no longer public companies) assuming an initial investment of $100 and reinvestment of dividends.




| Description | Starting Basis 2/2/02 | 2/1/03 | 1/31/04 | 1/29/05 | 1/28/06 | 2/3/07 |
|---|---|---|---|---|---|---|
| Saks Incorporated | $ 100.00 | $ 88.25 | $ 169.32 | $ 155.50 | $ 214.21 | $ 338.53 |
| S&P Midcap 400 | $ 100.00 | $ 83.59 | $ 119.31 | $ 130.65 | $ 160.93 | $ 177.12 |
| S&P 500 Department Stores | $ 100.00 | $ 68.37 | $ 93.23 | $ 109.79 | $ 128.19 | $ 184.37 |
| Retail Peer Group | $ 100.00 | $ 67.94 | $ 114.85 | $ 144.16 | $ 201.23 | $ 273.20 |

This "Performance Graph" section shall not be deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C, or to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended (the "1934 Act").

***Dividends***

During the fiscal year ended February 3, 2007, the Company declared a cash dividend of $4.00 per share of common stock payable on May 1, 2006 to holders of record on April 14, 2006. The dividend totaled approximately $548 million. During the same fiscal year, the Company declared a second cash dividend of $4.00 per share of common stock payable on November 30, 2006 to holders of record on November 15, 2006. The dividend totaled approximately $559 million. Future dividends, if any, will be determined by the Company's

Table of Contents

Index to Financial Statements
Board of Directors in light of circumstances then existing, including earnings, financial requirements, and general business conditions.

***Purchases of Equity Securities by the Issuer and Affiliated Purchasers***

The Company has a share repurchase program that authorizes it to purchase shares of the Company's common stock in order to both distribute cash to stockholders and manage dilution resulting from shares issued under the Company's equity compensation plans. The Company purchased approximately 691 thousand shares of common stock during the year ended February 3, 2007 for a total of approximately $11.4 million. The Company has remaining availability of approximately 37.2 million shares under its 70 million share repurchase authorization. The following are details of repurchases under this program for the fourth quarter of fiscal 2006:

| Period (in thousands except average price paid per share) | Total Number of Shares Repurchased | Average Price Paid per Share | Total Number of Shares Repurchased as Part of Publicly Announced Authorizations | Maximum Number of Shares that May Yet Be Repurchased Under the Announced Authorizations (a) |
|---|---|---|---|---|
| Repurchases from October 29, 2006 through November 25, 2006 | 225 | $ 19.84 | 225 | 37,155 |
| Repurchases from November 26, 2006 through December 30, 2006 | 1 | $ 16.88 | 1 | 37,154 |
| Repurchases from December 31, 2006 through February 3, 2007 | 15 | $ 19.01 | 15 | 37,139 |
| Total | 241 | $ — | 241 | |

(a) As of February 3, 2007, the Company's Board of Directors has authorized 70.0 million total shares. The Company has utilized 32.8 million of these shares to date.

**Item 6. Selected Financial Data.**

The selected financial data set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's Consolidated Financial Statements and notes thereto and the other information contained elsewhere in this Form 10−K.

| | Year Ended | | | | |
|---|---|---|---|---|---|
| | February 3, | January 28, | January 29, | January 31, | February 1, |
| (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | 2007** | 2006 | 2005 | 2004 | 2003 |
| **CONSOLIDATED INCOME STATEMENT DATA:** | | | | | |
| Net sales | $2,940,003 | $2,778,333 | $2,766,977 | $2,441,989 | $2,331,659 |
| Cost of sales (excluding depreciation and amortization) | 1,804,294 | 1,754,833 | 1,681,297 | 1,483,676 | 1,436,118 |
| Gross margin | 1,135,709 | 1,023,500 | 1,085,680 | 958,313 | 895,541 |
| Selling, general and administrative expenses | 819,218 | 830,495 | 796,574 | 687,484 | 635,144 |
| Other operating expenses | 324,451 | 328,799 | 318,843 | 310,107 | 308,594 |
| Impairments and dispositions | 12,443 | (7,848) | 20,768 | 5,360 | 3,245 |
| Operating loss | (20,403) | (127,946) | (50,505) | (44,638) | (51,442) |
| Interest expense | (50,136) | (77,188) | (104,773) | (107,927) | (118,591) |
| Gain (loss) on extinguishment of debt | 7 | (29,375) | — | (10,506) | 709 |
| Other income, net | 28,407 | 7,705 | 4,048 | 5,004 | 2,112 |
| Loss before income taxes and cumulative effect of accounting change | (42,125) | (226,804) | (151,230) | (158,067) | (167,212) |
| Benefit for income taxes | (34,783) | (93,161) | (71,024) | (80,368) | (66,664) |
| Loss before cumulative effect of accounting change | (7,342) | (133,643) | (80,206) | (77,699) | (100,548) |
| Cumulative effect of change in accounting principle, net of taxes | — | — | — | — | (45,593)* |
| Loss from continuing operations | (7,342) | (133,643) | (80,206) | (77,699) | (146,141) |
| Discontinued operations: | | | | | |
| Income from discontinued operations | 193,377 | 321,443 | 235,468 | 252,263 | 264,114 |
| Provision for income taxes | 132,293 | 165,452 | 94,177 | 102,200 | 105,864 |
| Income from discontinued operations | 61,084 | 155,991 | 141,291 | 150,063 | 158,250 |
| Net income | $ 53,742 | $ 22,348 | $ 61,085 | $ 72,364 | $ 12,109 |
| Basic earnings per common share: | | | | | |
| Loss from continuing operations | $ (0.05) | $ (0.97) | $ (0.58) | $ (0.56) | $ (0.70) |
| Income from discontinued operations | $ 0.45 | $ 1.13 | $ 1.01 | $ 1.07 | $ 1.11 |
| Net Income | $ 0.40 | $ 0.16 | $ 0.44 | $ 0.52 | $ 0.08 |
| Diluted earnings per common share: | | | | | |
| Loss from continuing operations | $ (0.05) | $ (0.97) | $ (0.58) | $ (0.56) | $ (0.70) |
| Income from discontinued operations | $ 0.45 | $ 1.13 | $ 1.01 | $ 1.07 | $ 1.11 |
| Net Income | $ 0.40 | $ 0.16 | $ 0.44 | $ 0.52 | $ 0.08 |
| Weighted average common shares: | | | | | |
| Basic | 135,880 | 138,348 | 139,470 | 139,824 | 142,750 |
| Diluted | 135,880 | 138,348 | 139,470 | 139,824 | 142,750 |
| **CONSOLIDATED BALANCE SHEET DATA:** | | | | | |
| Working capital | $ 388,061 | $ 799,601 | $1,115,460 | $1,060,094 | $1,151,176 |
| Total assets | $2,544,303 | $3,850,725 | $4,709,014 | $4,684,357 | $4,611,788 |
| Long−term debt, less current portion | $ 450,010 | $ 722,736 | $1,346,222 | $1,125,637 | $1,327,381 |
| Shareholders' equity | $1,096,139 | $1,999,383 | $2,062,418 | $2,271,337 | $2,221,615 |
| Cash dividends (per share) | $ 8.00 | $ — | $ 2.00 | $ — | $ — |

* Represents the cumulative effect of a change in accounting for goodwill in accordance with SFAS No. 142.

** The year ended February 3, 2007 includes an extra week, creating a 53−week fiscal year that occurs every six years in the accounting cycle.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

Management's Discussion and Analysis ("MD&A") is intended to provide an analytical view of the business from management's perspective of operating the business and is considered to have these major components:

- Overview
- Results of Operations
- Liquidity and Capital Resources
- Critical Accounting Policies

MD&A should be read in conjunction with the consolidated financial statements and related notes thereto contained elsewhere in this Form 10−K.

**OVERVIEW**

***GENERAL***

Saks Incorporated and its subsidiaries (together the "Company") operations consist of Saks Fifth Avenue ("SFA"), Off Fifth, and Club Libby Lu ("CLL"). Previously, the Company also operated Saks Department Store Group ("SDSG"), which consisted of Proffitt's and McRae's ("Proffitt's") (sold to Belk, Inc. ("Belk") in July 2005), the Northern Department Store Group ("NDSG") (operated under the nameplates of Bergner's, Boston Store, Carson Pirie Scott, Herberger's and Younkers and sold to The Bon−Ton Stores, Inc. ("Bon−Ton") in March 2006), and Parisian (sold to Belk in October 2006). The sold businesses are presented as discontinued operations in the consolidated statements of income and the consolidated statements of cash flows for the current and prior year periods and are discussed below at "Discontinued Operations."

Saks Fifth Avenue stores are principally free−standing stores in exclusive shopping destinations or anchor stores in upscale regional malls, and the stores typically offer a wide assortment of distinctive luxury fashion apparel, shoes, accessories, jewelry, cosmetics and gifts. Customers may also purchase Saks Fifth Avenue products by catalog or online at saks.com. Off Fifth is intended to be the premier luxury off−price retailer in the United States and provides an outlet for the sale of end−of−season clearance merchandise. Off Fifth stores are primarily located in upscale mixed−use and off−price centers and offer luxury apparel, shoes, accessories, cosmetics and decorative home furnishings, targeting the value−conscious customer. Club Libby Lu consists of mall−based specialty stores, targeting girls aged 4−12 years old.

The Company seeks to create value for its shareholders by improving returns on its invested capital. The Company attempts to generate improved operating margins by generating sales increases while improving merchandising margins and controlling expenses. The Company uses operating cash flows to reinvest in the business and to repurchase debt or equity. The Company actively manages its real estate portfolio by routinely evaluating opportunities to improve or close underproductive stores and open new units.

***DISCONTINUED OPERATIONS***

On July 5, 2005, Belk acquired from the Company for $622.7 million in cash substantially all of the assets directly involved in the Company's Proffitt's business operations, plus the assumption of approximately $1 million in capitalized lease obligations and the assumption of certain other ordinary course liabilities associated with the acquired assets. The assets sold included the real and personal property and inventory associated with 22 Proffitt's stores and 25 McRae's stores that generated fiscal 2004 revenues of approximately $784 million. The Company realized a net gain of $155.5 million on the sale.

On March 6, 2006, the Company sold to Bon−Ton all outstanding equity interests of certain of the Company's subsidiaries that owned NDSG, either directly or indirectly. The consideration received consisted of approximately $1.12 billion in cash (reduced as described below based on changes in working capital), plus the assumption by Bon−Ton of approximately $35 million of unfunded benefit liabilities and approximately $35 million of capital leases. A working capital adjustment based on working capital as of the effective time of the transaction reduced the amount of cash proceeds by approximately $75 million resulting in net cash proceeds to the Company of approximately $1.04 billion. The disposition included NDSG's operations consisting of, among other things, the following: the real and personal property, operating leases and inventory associated with 142 NDSG units (31 Carson Pirie Scott stores, 14 Bergner's stores, 10 Boston Store stores, 40 Herberger's stores, and 47 Younkers stores), the administrative/headquarters facilities in Milwaukee, Wisconsin and distribution centers located in Rockford, Illinois, Naperville, Illinois, Green Bay, Wisconsin, and Ankeny, Iowa. NDSG generated fiscal 2005 revenues of approximately $2.2 billion. The Company realized a net gain of $204.7 million on the sale.

On October 2, 2006, the Company sold to Belk of all of the outstanding equity interests of the Company's subsidiaries that conducted the Parisian specialty department store business ("Parisian"). The consideration received consisted of $285.0 million in cash (increased in accordance with a working capital adjustment described below). In addition, Belk reimbursed the Company at closing for $6.7 million in capital expenditures incurred in connection with the construction of four new Parisian stores. Belk also paid the Company a premium associated with the purchase of accounts and accounts receivable from Household Bank (SB), N.A. (now known as HSBC Bank Nevada, N.A., "HSBC"), in the amount of $2.3 million. A working capital adjustment based on working capital as of the effective time of the transaction increased the amount of cash proceeds by $14.2 million resulting in total net cash proceeds of $308.2 million. The disposition included Parisian's operations consisting of, among other things, the following: real and personal property, operating leases and inventory associated with 38 Parisian stores (which generated fiscal 2005 revenues of approximately $740 million), an administrative/headquarters facility in Birmingham, Alabama and a distribution center located in Steele, Alabama. The Company realized a net loss of $12.8 million on the sale.

### *SAKS FIFTH AVENUE NEW ORLEANS STORE*

In late August 2005, the Saks Fifth Avenue ("SFA") store in New Orleans suffered substantial water, fire, and other damage related to Hurricane Katrina. The Company reopened the store in the fourth fiscal quarter of 2006 after necessary repairs and renovations were made to the property.

The SFA New Orleans store was covered by both property damage and business interruption insurance. The property damage coverage paid to repair and/or replace the physical property damage and inventory loss, and the business interruption coverage is expected to reimburse the Company for lost profits as well as continuing expenses related to loss mitigation, recovery, and reconstruction for the full duration of the reconstruction period plus three months. The Company recorded in 2005 both (i) a $14.7 million gain on the excess of the replacement insurance value over the recorded net book value of the lost and damaged assets and (ii) $2.6 million of expenses related to the insurance deductible. In 2006, the Company recorded an adjustment (credit) of $1.6 million related to the insurance deductible. Subsequent to the re−opening of the store in the fourth quarter of 2006, the Company submitted its business interruption claims to its insurance carrier.

### *FINANCIAL PERFORMANCE SUMMARY*

On a consolidated basis, net sales for the year ended February 3, 2007 increased 5.8%, while comparable store sales grew 4.9%. The Company recorded a loss from continuing operations of $7.3 million, or $0.05 per share compared to a loss from continuing operations of $133.6 million, or $0.97 per share, for the years ended February 3, 2007 and January 28, 2006, respectively. After recognition of the Company's after−tax gain from discontinued operations of $61.1 million, or $0.45 per share, net income totaled $53.7 million, or $0.40 per share for the year ended February 3, 2007. Comparably, net income for the year ended January 28, 2006 totaled $22.3 million, or $0.16 per share, after recognition of the Company's after−tax gain on discontinued operations of $156.0 million.

The year ended February 3, 2007 included net after−tax charges totaling $28.8 million, or $.21 per share, primarily related to a $21.0 million (net of taxes), or $0.15 per share, non−cash charge related to the accounting treatment under the Statement of Financial Accounting Standard (SFAS) No. 123R "Accounting for Stock−Based Compensation," (SFAS No. 123R) of the discretionary anti−dilution adjustment made to outstanding options in connection with the Company's $4 per common share dividends paid in May and November 2006 and $7.8 million (net of taxes), or $0.06 per share, of other charges primarily related to asset impairments and dispositions. The comparable prior year period included a net after−tax loss of $15.1 million or $0.11 per share, primarily due to a $17.9 million (net of taxes), or $0.13 per share, loss on debt extinguishment, $3.2 million (net of taxes), or $0.02 per share, of charges primarily related to impairments and dispositions and a $2.9 million (net of taxes), or $0.02 per share, CLL goodwill impairment charge, partially offset by net gains of $8.9 million (net of taxes), or $0.06 per share, principally related to the insurance settlement on the New Orleans store.

A summary of the 2006, 2005 and 2004 (charges)/gains are outlined below:

| | Year Ended | | |
|---|---|---|---|
| | **February 3, 2007** | **January 28, 2006** | **January 29, 2005** |
| SFAE Store Closings: | | | |
| Impairments and Dispositions | $ (6,353) | $ 2,625 | $ (17,295) |
| Gross Margin (markdowns) | — | (241) | (7,136) |
| SG&A (principally severance) | (268) | (1,316) | (3,711) |
| Other Impairments and Dispositions | (6,088) | 8,209 | (3,473) |
| Option Expense Due to Dividend | (33,351) | — | — |
| Gain (Loss) on Debt Extinguishment | 7 | (29,375) | — |
| Goodwill Impairment | — | (2,987) | — |
| Other | (254) | 112 | — |
| Income Taxes: | | | |
| Income Tax Effect of Above Items | 17,477 | 7,846 | 11,539 |
| Change in Income Tax Reserves | | | (2,555) |
| **TOTAL** | **$(28,830)** | **$ (15,127)** | **$ (22,631)** |

Additionally, several other items were included in the current year's results, including expenses of approximately $3.6 million (net of taxes), or $0.03 per share, related to legal and other costs associated with the previously disclosed investigations, expenses of approximately $22.3 million (net of taxes), or $0.16 per share, related to retention and severance, income of approximately $16.8 million (net of taxes), or $0.12 per share, due to the favorable conclusion of certain tax examinations and the adjustment of certain tax valuation allowances, a gain of $2.6 million (net of taxes), or $0.02 per share, related to a one−time gain on the curtailment of the Company's pension plan, and an insurance adjustment (credit) of $1.0 million (net of taxes), or $0.01 per share, related to the New Orleans store. The prior year ended January 28, 2006 also included legal and other expenses related to the investigations totaling approximately $12.0 million (net of taxes), or $0.09 per share, approximately $15.4 million (net of taxes), or $0.11 per share, of severance and retention expenses, expenses of $1.6 million (net of taxes), or $0.01 per share, related to the insurance deductible for the New Orleans store, and income of $1.0 million (net of taxes), or $0.01 per share, relating to the Visa/MasterCard antitrust litigation settlement.

The year ended February 3, 2007 includes an extra week, creating a 53−week fiscal year that occurs every six years in the accounting cycle for many retailers. Management estimates that the 53rd week added $0.06 per share to earnings per share in the current year.

The retail environment is challenging and competitive. Uncertain conditions make the forecasting of near−term results difficult. The Company believes that execution of key strategic initiatives, as well as its expectations for long−term growth in the luxury retail market will provide the Company an opportunity and the methods to create shareholder value.

The Company believes that an understanding of its reported financial condition and results of operations is not complete without considering the effect of all other components of MD&A included herein.

**RESULTS OF OPERATIONS**

The following table sets forth, for the periods indicated, selected items from the Company's consolidated statements of income, expressed as percentages of net sales (numbers may not total due to rounding):

| | Year Ended | | |
|---|---|---|---|
| | February 3, 2007 | January 28, 2006 | January 29, 2005 |
| Net sales | 100.0% | 100.0% | 100.0% |
| Cost of sales (excluding depreciation and amortization) | 61.4 | 63.2 | 60.8 |
| Gross margin | 38.6 | 36.8 | 39.2 |
| Selling, general and administrative expenses | 27.9 | 29.9 | 28.8 |
| Other operating expenses | 11.0 | 11.8 | 11.6 |
| Impairments and dispositions | 0.4 | (0.3) | 0.8 |
| Operating loss | (0.7) | (4.6) | (1.8) |
| Interest expense | (1.7) | (2.8) | (3.8) |
| Gain (loss) on extinguishment of debt | 0.0 | (1.1) | 0.0 |
| Other income, net | 1.0 | 0.3 | 0.1 |
| Loss before income taxes | (1.4) | (8.2) | (5.5) |
| Benefit for income taxes | (1.2) | (3.4) | (2.6) |
| Loss from continuing operations | (0.2) | (4.8) | (2.9) |
| Discontinued operations: | | | |
| Income from discontinued operations (including gain (loss) on disposal) | 6.5 | 11.6 | 8.5 |
| Provision for income taxes | 4.5 | 6.0 | 3.4 |
| Income from discontinued operations | 2.1 | 5.6 | 5.1 |
| Net income | 1.8% | 0.8% | 2.2% |

***FISCAL YEAR ENDED FEBRUARY 3, 2007 ("2006") COMPARED TO FISCAL YEAR ENDED***

***JANUARY 28, 2006 ("2005")***

***DISCUSSION OF OPERATING INCOME — CONTINUING OPERATIONS***

The following table shows the changes in operating income from 2005 to 2006:

| (In Millions) | Total Company |
|---|---|
| **FY 2005 Operating Loss — Continuing Operations** | $ (127.9) |
| Store sales and margin | 112.2 |
| Operating expenses | 15.6 |
| Impairments and dispositions | (20.3) |
| Change | 107.5 |
| **FY 2006 Operating Loss — Continuing Operations** | $ (20.4) |

For the year ended February 3, 2007, the Company's operating loss totaled $20.4 million, an 84% improvement from the $127.9 million loss in the same period last year. Operating income was positively impacted by a 4.9% increase in comparable store sales, a 180 basis point improvement in the gross margin rate due to improved sell−throughs of full priced merchandise, and an $11.3 million decline in SG&A expenses. The SG&A expense reduction was primarily due to improved expense leverage resulting from expense control, coupled with increasing comparable store sales, continued progress on the Company's corporate infrastructure downsizing, and the elimination or reduction of items that the Company does not expect to be long−term continuing obligations such as investigation expenses, severance/retention expenses, and insurance deductible expenses related to the New Orleans store. The improvement in operating income was partially offset by a $33.4 million FAS 123R charge associated with the discretionary anti−dilution adjustment on outstanding options and by a $20.3 million year−over−year increase in impairments and dispositions costs, primarily resulting from the $14.7 million gain recognized in the prior year related to the New Orleans store insurance settlement.

***NET SALES***

For the year ended February 3, 2007, total sales increased 5.8% to $2,940.0 million from $2,778.3 million for the year ended January 28, 2006, and consolidated comparable store sales increased 4.9%. The net effect of sales from new and closed stores resulted in a $13.7 million reduction, while the net effect of the New Orleans store also resulted in a $13. 7 million reduction. The year ended February 3, 2007 also includes an extra week, creating a 53−week fiscal year that occurs every six years in the accounting cycle for many retailers and resulted in a $43.6 million increase in sales.

Comparable store sales are calculated on a rolling 13−month basis. Thus, to be included in the comparison, a store must be open for 13 months. The additional month is used to transition the first month impact of a new store opening. Correspondingly, closed stores are removed from the comparable store sales comparison when they begin liquidating merchandise. Expanded, remodeled, converted and re−branded stores are included in the comparable store sales comparison, except for the periods in which they are closed for remodeling and renovation.

***GROSS MARGIN***

For the year ended February 3, 2007, gross margin was $1,135.7 million, or 38.6% of net sales, compared to $1,023.5 million, or 36.8% of net sales, for the year ended January 28, 2006. The improvement in gross margin dollars was due to the comparable sales increase of 4.9% and an improved gross margin rate. The increased gross margin rate was principally attributable to improved sell−throughs of full priced merchandise.

***SELLING, GENERAL AND ADMINISTRATIVE EXPENSES***

For the year ended February 3, 2007, SG&A was $819.2 million, or 27.9% of net sales, compared to $830.5 million, or 29.9% of net sales, for the year ended January 28, 2006. The net decrease of $11.3 million in expenses was principally due to expense improvement resulting from the Company's corporate infrastructure downsizing, offset partially by the $33.4 million current period charge associated with SFAS 123R. Additionally, SG&A expense decreased as a result of a $14.5 million decrease in investigation related expenses, a $4.3 million reduction in insurance deductible expenses related to the New Orleans store, and a $4.3 million reduction in pension expense related to the pension curtailment gain, and SG&A increased as a result of an $11.0 million increase in incentive compensation and a year−over−year increase of $11.1 million in retention costs associated with the SDSG strategic alternatives process.

Amounts received from vendors in conjunction with compensation programs and cooperative advertising were consistent with the related gross compensation and cooperative advertising expenditures and therefore had no impact on SG&A expense, in dollars or as a percentage of net sales.

***OTHER OPERATING EXPENSES***

For the year ended February 3, 2007, other operating expenses, including store pre−opening costs, were $324.5 million, or 11.0% of net sales, compared to $328.8 million, or 11.8% of net sales, for the year ended January 28, 2006. As a percent of sales, other operating expenses decreased slightly, reflecting the ability to leverage essentially flat costs and a comparable store sales increase.

***IMPAIRMENTS AND DISPOSITIONS***

For the year ended February 3, 2007, the Company recognized net charges from impairments and dispositions of $12.4 million compared to net gains of $7.8 million for the year ended January 28, 2006. The current period net charges were primarily due to impairments and disposition charges in the normal course of business and lease termination costs related to store closings, while the prior period net gains primarily related to the insurance settlement received on the New Orleans store, partially offset by impairments and dispositions in the normal course of business.

***INTEREST EXPENSE***

Interest expense declined to $50.1 million in 2006 from $77.2 million in 2005 and, as a percentage of net sales, decreased to 1.7% in 2006 from 2.8% in 2005. The improvement of $27.1 million was due to the reduction in debt resulting from the repurchase of approximately $585.7 million and $21.4 million of senior notes in July 2005 and August 2005, respectively.

***GAIN/(LOSS) ON EXTINGUISHMENT OF DEBT***

During the year ended February 3, 2007, the Company repurchased a total of approximately $0.2 million in principal amount of senior notes. The repurchase of these notes resulted in a gain on extinguishment of debt of $7 thousand. For the year ended January 28, 2006, the Company repurchased a total of approximately $607.1 million in principal amount of senior notes. The repurchase of these notes resulted in a loss on extinguishment of debt of approximately $29.4 million related principally to the write−off of deferred financing costs and a premium on previously exchanged notes.

***OTHER INCOME, NET***

Other income increased to $28.4 million in 2006 from $7.7 million in 2005 due principally to increased short−term investments as the Company invested the cash proceeds from the NDSG and Parisian dispositions prior to the payment of the May and November $4 per common share dividends.

***INCOME TAXES***

For 2006 and 2005 the effective income tax rate differs from the federal statutory tax rate due to state income taxes and other items such as executive compensation, tax−exempt interest, the change in state deferred tax rates, the change in valuation allowance against state net operating loss carryforwards, and the effect of concluding tax examinations. Excluding these items, the Company's effective income tax rate was 48.7% and 41.1% in 2006 and 2005, respectively. Management anticipates that income tax rates in future years will be closer to 40%.

***FISCAL YEAR ENDED JANUARY 28, 2006 ("2005") COMPARED TO FISCAL YEAR ENDED***

***JANUARY 29, 2005 ("2004")***

***DISCUSSION OF OPERATING INCOME — CONTINUING OPERATIONS***

The following table shows the changes in operating income from 2004 to 2005:

| (In Millions) | Total Company |
|---|---|
| **FY 2004 Operating Loss — Continuing Operations** | $ (50.5) |
| Store sales and margin | (62.2) |
| Operating expenses | (43.8) |
| Impairments and dispositions | 28.6 |
| Decrease | (77.4) |
| **FY 2005 Operating Loss — Continuing Operations** | $ (127.9) |

For the year ended January 28, 2006, the Company's operating loss increased to $127.9 million from an operating loss of $50.5 million in the same period last year. The $77.4 million increase in operating loss for the year was largely driven by a 240 basis point deterioration in the gross margin rate as well as a $33.9 million or 4.3% increase in SG&A expenses, partially offset by lower impairment and disposition charges. The gross margin rate declined substantially, related to (i) unsatisfactory inventory management, which led to substantially higher markdowns and (ii) a year−over−year decline in vendor markdown support. Additionally, an increase in SG&A expenses primarily reflected costs associated with the previously mentioned investigations; the SFA New Orleans store insurance deductible; investments in marketing, store and other key strategic initiatives; and certain costs related to organizational changes. Excluding the closure of the New Orleans store, which reduced operating income by $13.4 million, the net effect of new and closed stores reduced operating income by $11.7 million.

***NET SALES***

For the year ended January 28, 2006, total sales increased 0.4% to $2,778.3 million from $2,767.0 million for the year ended January 29, 2005. Consolidated comparable store sales increased 4.0%, while total sales were negatively affected by approximately $26 million for 2005 due to the SFA New Orleans store closing.

***GROSS MARGIN***

For the year ended January 28, 2006, gross margin was $1,023.5 million, or 36.8% of net sales, compared to $1,085.7 million, or 39.2% of net sales, for the year ended January 29, 2005. Aside from the lost contribution from the 2004 SFA store closings which totaled approximately $52 million, the reduction in gross margin dollars and rate was primarily attributable to key members of management, the merchandising team, and the finance group being largely focused on activities surrounding the investigations and a consequential amount of merchant turnover took place during the period. In addition, due to the ongoing investigations, SFA's ability to collect certain vendor markdown allowances was impacted principally during the first half of the year, which negatively affected gross margin.

***SELLING, GENERAL AND ADMINISTRATIVE EXPENSES***

For the year ended January 28, 2006, SG&A was $830.5 million, or 29.9% of net sales, compared to $796.6 million, or 28.8% of net sales, for the year ended January 29, 2005. The net increase of $33.9 million in expenses was principally due to costs associated with the previously mentioned investigations, equity compensation and retention compensation totaling $52.5 million. The net effect of new and closed stores decreased SG&A by approximately $17.8 million.

Amounts received from vendors in conjunction with compensation programs and cooperative advertising were consistent with the related gross compensation and cooperative advertising expenditures and therefore had no impact on SG&A expense, in dollars or as a percentage of net sales.

***OTHER OPERATING EXPENSES***

For the year ended January 28, 2006, other operating expenses, including store pre−opening costs, were $328.8 million, or 11.8% of net sales, compared to $318.8 million, or 11.6% of net sales, for the year ended January 29, 2005. The increase of $10.0 million was principally the result of capital expenditures related to store remodels and expansions.

***IMPAIRMENTS AND DISPOSITIONS***

For the year ended January 28, 2006, the Company recognized net gains from impairments and dispositions of $7.8 million compared to net charges of $20.8 million for the year ended January 29, 2005. The current period net gains primarily related to the insurance settlement received on the New Orleans SFA store, partially offset by impairment and disposition charges in the normal course of business. Prior year charges were principally due to the impairment of store assets related to the SFA store closings and other impairment and disposition charges in the normal course of business.

***INTEREST EXPENSE***

Interest expense declined to $77.2 million in 2005 from $104.8 million in 2004 and, as a percentage of net sales, decreased to 2.8% in 2005 from 3.8% in 2004. The improvement of $27.6 million was due to the reduction in debt resulting from the repurchase of approximately $585.7 million and $21.4 million of senior notes in July 2005 and August 2005, respectively.

***LOSS ON EXTINGUISHMENT OF DEBT***

During July 2005 the Company repurchased a total of approximately $585.7 million in principal amount of senior notes. The notes were repurchased at par, which included a consent fee. Additionally, during August 2005, the Company repurchased $21.4 million of additional senior notes at par through open market repurchases. The repurchase of these notes resulted in a loss on extinguishment of debt of approximately $29.4 million related principally to the write−off of deferred financing costs and a premium on previously exchanged notes.

***OTHER INCOME, NET***

Other income increased to $7.7 million in 2005 from $4.0 million in 2004 due principally to higher yields on invested cash in 2005.

***INCOME TAXES***

For 2005 and 2004 the effective income tax rate differs from the federal statutory tax rate due to state income taxes and other items such as the change in valuation allowance against state net operating loss carryforwards, the change in state deferred tax rates, the effect of concluding tax examinations, and other adjustments to income tax reserves. Excluding these items, the Company's effective income tax rate was 41.1% and 41.9% in 2005 and 2004, respectively.

**LIQUIDITY AND CAPITAL RESOURCES**

***CASH FLOW***

The primary needs for cash are to acquire or construct new stores, renovate and expand existing stores, provide working capital for new and existing stores and service debt. The Company anticipates that cash on hand, cash generated from operating activities and borrowings under its revolving credit agreement will be sufficient to meet its financial commitments and provide opportunities for future growth.

Cash provided by operating activities from continuing operations was $151.0 million in 2006, $35.3 million in 2005 and $48.8 million in 2004. Cash provided by operating activities principally represents income before depreciation and amortization charges and losses from impairments and dispositions. The changes in working capital in 2006 from 2005 was largely due to the change in deferred income taxes. The decrease in 2005 from 2004 was primarily due to an increase in prepaid expenses and other current assets offset by a decrease in inventory and related accounts payable.

Cash used in investing activities from continuing operations was $(123.5) million in 2006, $(116.9) million in 2005 and $(78.8) million in 2004. Cash used in investing activities principally consists of construction of new stores and renovation and expansion of existing stores and investments in support areas (e.g., technology, distribution centers, e−business infrastructure). The $6.6 million increase in net cash used in 2006 is primarily due to virtually no proceeds received from the sale of property and equipment in the current year versus $13.2 million of proceeds received in the prior year. The $38.1 million increase in net cash used in 2005 was primarily attributable to an increase in capital spending related to new stores.

Cash used in financing activities from continuing operations was $(1,041.2) million in 2006, $(762.2) million in 2005 and $(284.7) million in 2004. The 2006 use primarily relates to the payment of cash dividends totaling $1,095.0 million, while the 2005 use primarily relates to the repurchase of approximately $607.1 million in principal amount of senior notes due to the completion of the tender offers and consent solicitations. The 2004 use was principally attributable to payments of a $283.1 million cash dividend and $142.6 million of 2004 senior note maturities and subsequent open market repurchases, offset by net proceeds received from the issuance of $230.0 million of convertible notes during 2004.

***CASH BALANCES AND LIQUIDITY***

The Company's primary sources of short−term liquidity are comprised of cash on hand and availability under its revolving credit facility. At the Company's request, due to the sale of NDSG, the revolving credit facility was reduced from $800 million to $500 million in March 2006. In September 2006, the maturity date of the revolving credit facility was extended to September 2011. At February 3, 2007 and January 28, 2006, the Company maintained cash and cash equivalent balances of $277.9 million and $80.4 million (including $3 million of NDSG store cash held for sale), respectively. Exclusive of approximately $12 million and $34 million of store operating cash at February 3, 2007 and January 28, 2006, respectively, cash was invested principally in various money market funds at February 3, 2007 and January 28, 2006, respectively. There was no restricted cash at February 3, 2007 and January 28, 2006.

At February 3, 2007, the Company had no borrowings under its $500 million revolving credit facility, and had $48.3 million in unfunded letters of credit, leaving unutilized availability under the facility of $451.7million. The Company had maximum unfunded letters of credit of $137.1 million on its revolving credit facility during 2006. The amount of cash on hand and borrowings under the facility are influenced by a number of factors, including sales, inventory levels, vendor terms, the level of capital expenditures, cash requirements related to financing instruments, and the Company’s tax payment obligations, among others.

The Company continuously focuses on effectively and efficiently deploying cash to generate shareholder value. Accordingly, the Company plans to maintain a portion of its existing cash on hand to provide flexibility for further balance sheet refinements, to invest in its core businesses, and to cover any transition costs related to the disposition of Proffitt’s, NDSG and Parisian.

On March 6, 2006, the Company’s Board of Directors declared a cash dividend to shareholders of $4.00 per common share. On May 1, 2006, the Company paid approximately $539 million to shareholders of record as of April 14, 2006. The remaining portion of the dividends will be paid prospectively as, and to the extent, awards of restricted stock and performance shares vest.

On August 30, 2006, the Company repurchased 450 thousand shares of Saks’ common stock at a cost of approximately $6.5 million, which left 37.4 million shares available for repurchase under the Company’s existing share repurchase program.

On October 3, 2006 the Company’s Board of Directors declared a cash dividend of $4.00 per share of the Company’s common stock, and the Company reduced shareholders’ equity for the $558.6 million dividend. Approximately $549.0 million of the dividend was paid on November 30, 2006 to shareholders of record as of November 15, 2006. The remaining portion of the dividends will be paid prospectively as, and to the extent, awards of restricted stock and performance shares vest.

***CAPITAL STRUCTURE***

The Company continuously evaluates its debt−to−capitalization ratio in light of the Company’s disposition of businesses, economic trends, business trends, levels of interest rates, and terms, conditions and availability of capital in the capital markets. At February 3, 2007, the Company’s capital and financing structure was comprised of a revolving credit agreement, senior unsecured notes, convertible senior unsecured notes, and capital and operating leases. At February 3, 2007, total debt was $686.7 million, representing a decrease of $43.8 million from the balance of $730.5 million at January 28, 2006. This decrease in debt was primarily the result of the $33.8 million and the $1.9 million reduction in capital leases associated with the sale of NDSG and Parisian, respectively. Despite the decrease in debt, the debt−to−capitalization ratio increased to 38.5% from 26.8% in the prior year due to a reduction in Shareholders’ Equity, primarily related to the March 6, 2006 and the October 3, 2006 $4.00 per share dividends.

At February 3, 2007, the Company maintained a $500 million senior revolving credit facility maturing in 2011, which is secured by inventory and certain third party credit card accounts receivable. Borrowings are limited to a prescribed percentage of eligible inventories and receivables. There are no debt ratings−based provisions in the facility. The facility includes a fixed−charge coverage ratio requirement of 1 to 1 that the Company is subject to only if availability under the facility becomes less than $60 million. The facility contains default provisions that are typical for this type of financing, including a provision that would trigger a default of the facility if a default were to occur in another debt instrument resulting in the acceleration of principal of more than $20 million in that other instrument. At February 3, 2007, the Company had no borrowings under the revolving credit facility.

At February 3, 2007, the Company had $382.7 million of senior notes outstanding, excluding the convertible notes, comprised of five separate series having maturities ranging from 2008 to 2019 and interest rates ranging from 7.00% to 9.88%. The terms of each senior note call for all principal to be repaid at maturity. The senior notes have substantially identical terms except for the maturity dates and interest rates payable to investors. Each senior note contains limitations on the amount of secured indebtedness the Company may incur. The Company believes it has sufficient cash on hand, availability under its revolving credit facility and access to various capital markets to repay these notes at maturity.

On March 14, 2007, the Company announced that it had commenced a modified “Dutch Auction” tender offer to purchase a portion of its 8 $^{1}/4$% senior notes due November 15, 2008 for an aggregate purchase price not to exceed $100 million (the “offer cap”). Under the modified “Dutch Auction” procedure, the Company agreed to accept the senior notes validly tendered in the order of highest to lowest spreads specified by the holders and agreed to select the single highest spread that would enable the Company to purchase an amount of the senior notes having an aggregate purchase price up to the offer cap (or, if the senior notes having an aggregate purchase price less than the offer cap are validly tendered, all senior notes so tendered). The offer expires on April 11, 2007, unless extended.

The Company had $230 million of convertible senior notes, at February 3, 2007, that bear interest of 2.0% and mature in 2024. The provisions of the convertible notes allow the holder to convert the notes to shares of the Company’s common stock at a conversion rate of 83.5609 shares per one thousand dollars in principal amount of notes. The most significant terms and conditions of the senior notes include: the Company can settle a conversion with shares and/or cash; the holder may put the debt back to the Company in 2014 or 2019; the holder cannot convert until the Company’s share price exceeds the conversion price by 20% for a certain trading period; the Company can call the debt on or after March 11, 2011; the conversion rate is subject to a dilution adjustment; and the holder can convert upon a significant credit rating decline and upon a call. The Company used approximately $25 million of the proceeds from the issuances to enter into a convertible note hedge and written call options on its common stock to reduce the exposure to dilution from the conversion of the notes. The Company believes it has sufficient cash on hand, availability under its revolving credit facility and access to various capital markets to repay both the senior notes and convertible notes at maturity.

During the year ended February 3, 2007, the aforementioned conversion criterion was met. The closing price of the Company’s common stock exceeded 120% of the convertible senior notes’ conversion price for at least 20 out of 30 trading days in the fourth calendar quarter of 2006. The Company gave notice on January 3, 2007 that the holders of the convertible notes could convert them into shares of the Company’s common stock until March 30, 2007 in accordance with, and subject to, the terms of the convertible notes indenture. As of February 3, 2007, no note holders have converted their notes into the Company’s common stock. Since the holders of the convertible notes have the ability to exercise their conversion rights, the convertible notes were classified within the “current portion of long−term debt” on the Company’s February 3, 2007 balance sheet.

At February 3, 2007 the Company had $74.3 million in capital leases covering various properties and pieces of equipment. The terms of the capital leases provide the lessor with a security interest in the asset being leased and require the Company to make periodic lease payments, aggregating between $5 million and $7 million per year.

The Company is obligated to fund a cash balance pension plan. The Company's current policy is to maintain at least the minimum funding requirements specified by the Employee Retirement Income Security Act of 1974. The Company expects minimal funding requirements in 2007. As part of the sale of NDSG to Bon−Ton, the NDSG pension assets and liabilities were acquired by Bon−Ton. Additionally, the Company curtailed its SFA pension plan during 2006 which froze benefit accruals for all participants except those who have attained age 55 and completed 10 years of service as of January 1, 2007 and who continue to be highly compensated employees.

***CONTRACTUAL OBLIGATIONS***

The contractual cash obligations at February 3, 2007 associated with the Company's capital structure, as well as other contractual obligations are illustrated in the following table:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| **(Dollars in Millions)** | **Within 1 year** | **Years 2−3** | **Years 4−5** | **After Year 5** | **Total** |
| Long−Term Debt, including interest | $ 38 | $ 248 | $ 226 | $ 297 | $ 809 |
| Capital Lease Obligations, including interest | 17 | 31 | 29 | 127 | 204 |
| Operating Leases | 66 | 123 | 105 | 230 | 524 |
| Pension and Post Retirement Liabilities | 18 | 33 | 31 | 58 | 140 |
| Purchase Obligations | 676 | 33 | 19 | — | 728 |
| Total Contractual Cash Obligations | $815 | $ 468 | $ 410 | $ 712 | $2,405 |

The Company's purchase obligations principally consist of purchase orders for merchandise, store construction contract commitments, maintenance contracts, and services agreements and amounts due under employment agreements. Amounts committed under open purchase orders for merchandise inventory represent approximately $616 million of the purchase obligations within one year, a substantial portion of which are cancelable without penalty prior to a date that precedes the vendor's scheduled shipment date.

On March 6, 2006, the Company's Board of Directors declared a cash dividend of $4.00 per common share, and the Company reduced shareholders' equity for the $547.5 million dividend. Approximately $539.0 million of the dividend was paid on May 1, 2006 to shareholders of record as of April 14, 2006. On October 3, 2006 the Company's Board of Directors declared another cash dividend of $4.00 per common share, and the Company reduced shareholders' equity for the $558.6 million dividend. Approximately $549.0 million of the dividend was paid on November 30, 2006 to shareholders of record as of November 15, 2006. The remaining portion of the dividends will be paid prospectively as, and to the extent, awards of restricted stock and performance shares vest.

Additionally, at both February 3, 2007 and January 28, 2006, the Company had accrued approximately $20 million related to retention and severance compensation in conjunction with its SDSG strategic alternative processes.

Other cash obligations that have been excluded from the contractual obligations table include contingent rent payments, amounts that might come due under change−in−control provisions of employment agreements, common area maintenance costs, and deferred rentals. The Company voluntarily contributed approximately $11.8 million to the Company's pension plan in June 2006 and expects minimal funding requirements in 2007 and 2008.

The Company has not entered into any off−balance sheet arrangements which would be reasonably likely to have a current or future material effect, such as obligations under certain guarantees or contracts; retained or contingent interests in assets transferred to an unconsolidated entity or similar arrangements; obligations under certain derivative arrangements; and obligations under material variable interests.

***CREDIT CARDS***

Prior to April 15, 2003, the Company's proprietary credit cards were issued by National Bank of the Great Lakes ("NBGL"), a wholly owned subsidiary of the Company. On April 15, 2003, the Company sold its proprietary credit card portfolio, consisting of the proprietary credit card accounts owned by NBGL and the Company's ownership interest in the assets of a trust to HSBC, a third party financial institution.

As part of the transaction, for a term of ten years expiring in 2013 and pursuant to a program agreement, HSBC established and owns proprietary credit card accounts for customers of the Company's operating subsidiaries, retains the benefits and risks associated with the ownership of the accounts, receives the finance charge income and incurs the bad debts associated with those accounts. During the ten−year term, pursuant to a servicing agreement, the Company continues to provide key customer service functions, including new account opening, transaction authorization, billing adjustments and customer inquiries, and receives compensation from HSBC for these services.

At the end of the ten−year term expiring in 2013, the agreement can be renewed for two two−year terms. At the end of the agreement, the Company has the right to repurchase, at fair value, all of the accounts and outstanding accounts receivable, negotiate a new agreement with HSBC or begin issuing private label credit cards itself or through others. The agreement allows the Company to terminate the agreement early following the occurrence of certain events, the most significant of which would be HSBC's failure to pay owed amounts, bankruptcy, a change in control or a material adverse change in HSBC's ability to perform under the agreement. The agreement also allows for HSBC to terminate the agreement if the Company fails to pay owed amounts or enters bankruptcy. Should either the Company or HSBC choose to terminate the agreement early, the Company has the right, but not the requirement, to repurchase the credit card accounts and associated accounts receivable from HSBC at their fair value. The Company is contingently liable to pay monies to HSBC in the event of an early termination or a significant disposition of stores. The contingent payment is based upon a declining portion of an amount established at the beginning of the ten−year agreement and on a prorated portion of significant store closings. The maximum contingent payment had the agreement been terminated early at February 3, 2007 would have been approximately $33.0 million. Management believes the risk of incurring a contingent payment is remote.

In September of 2006 the company entered into agreements with HSBC and MasterCard to issue a co−branded MasterCard to new and existing proprietary credit card customers. Under this program, qualifying customers are issued a SFA and MasterCard branded credit card that functions as a traditional proprietary credit card when used at any SFA or Off 5th store and at Saks Direct or as a MasterCard when used at any unaffiliated location that accepts MasterCard. HSBC establishes and owns the co−brand accounts, retains the benefits and sales associated with the ownership of the accounts, receives the finance charge and other income from the accounts, and incurs the bad−debts associated with the accounts.

***CAPITAL NEEDS***

The Company estimates capital expenditures for 2007 will approximate $125 million to $150 million, net of any proceeds, primarily for store expansions and renovations, enhancements to management information systems, maintenance capital and replacement capital expenditures.

The Company anticipates that working capital requirements related to existing stores, store expansions, store renovations and capital expenditures will be funded through cash on hand, cash provided by operations and the revolving credit agreement. Maximum availability under the revolving credit agreement is $500 million. There is no debt rating trigger. During periods in which availability under the agreement exceeds $60 million, the Company is not subject to financial covenants. If availability under the agreement were to decrease to less than $60 million, the Company would be subject to a minimum fixed charge coverage ratio of 1 to 1. During 2006, weighted average letters of credit issued under this credit agreement were $96.8 million. The highest amount of letters of credit outstanding under the agreement during 2006 was $137.1 million. The Company expects to generate adequate cash flows from operating activities combined with borrowings under its revolving credit agreement in order to sustain its current levels of operations.

***CRITICAL ACCOUNTING POLICIES AND ESTIMATES***

The Company's critical accounting policies and estimates are discussed in the notes to the consolidated financial statements. Certain judgments and estimates utilized in implementing these accounting policies are likewise discussed in each of the notes to the consolidated financial statements. The following discussion aggregates the judgments and uncertainties affecting the application of these policies and estimates and the likelihood that materially different amounts would be reported under varying conditions and assumptions.

***REVENUE RECOGNITION***

Sales and the related gross margin are recorded at the time customers provide a satisfactory form of payment and take ownership of the merchandise. There are minimal accounting judgments and uncertainties affecting the application of this policy. The Company estimates the amount of goods that will be returned for a refund and reduces sales and gross margin by that amount. However, given that approximately 22% of merchandise sold is later returned and that the vast majority of merchandise returns are effected within a matter of days of the selling transaction, the risk of the Company realizing a materially different amount for sales and gross margin than reported in the consolidated financial statements is minimal.

***COST OF SALES AND INVENTORY VALUATION, EXCLUDING DEPRECIATION AND AMORTIZATION***

The Company's inventory is stated at the lower of LIFO cost or market using the retail method. Under the retail method, the valuation of inventories at cost and the resulting gross margins are determined by applying a calculated cost−to−retail ratio to the retail value of inventories. The cost of the inventory reflected on the consolidated balance sheet is decreased with a charge to cost of sales contemporaneous with the lowering of the retail value of the inventory on the sales floor through the use of markdowns. Hence, earnings are negatively impacted as the merchandise is being devalued with markdowns prior to the sale of the merchandise. The areas requiring significant management judgment include (1) setting the original retail value for the merchandise held for sale, (2) recognizing merchandise for which the customer's perception of value has declined and appropriately marking the retail value of the merchandise down to the perceived value, and (3) estimating the shrinkage that has occurred through theft during the period between physical inventory counts. These judgments and estimates, coupled with the averaging processes within the retail method, can, under certain circumstances, produce varying financial results. Factors that can lead to different financial results include setting original retail values for merchandise held for sale at too high a level, failure to identify a decline in perceived value of inventories and process the appropriate retail value markdowns and overly optimistic or overly conservative shrinkage estimates. The Company believes it has the appropriate merchandise valuation and pricing controls in place to minimize the risk that its inventory values would be materially under or overvalued.

The Company receives vendor provided support in different forms. When the vendor provides support for inventory markdowns, the Company records the support as a reduction to cost of sales. Such support is recorded in the period that the corresponding markdowns are taken. When the Company receives inventory−related support that is not designated for markdowns, the Company includes this support as a reduction in cost purchases.

***SELF−INSURANCE RESERVES***

The Company self−insures a substantial portion of the exposure for costs related primarily to employee medical, workers' compensation and general liability. Expenses are recorded based on estimates for reported and incurred but not reported claims considering a number of factors, including historical claims experience, severity factors, litigation costs, inflation and other assumptions. Although the Company does not expect the amount it will ultimately pay to differ significantly from estimates, self−insurance reserves could be affected if future claims experience differs significantly from the historical trends and assumptions.

***DEPRECIATION AND RECOVERABILITY OF CAPITAL ASSETS***

Over forty percent of the Company's assets at February 3, 2007 are represented by investments in property and equipment. Determining appropriate depreciable lives and reasonable assumptions for use in evaluating the carrying value of capital assets requires judgments and estimates.

- The Company principally utilizes the straight−line depreciation method and a variety of depreciable lives. Land is not depreciated. Buildings and improvements are depreciated over 20 to 40 years. Store fixtures are depreciated over 10 years. Equipment utilized in stores (e.g., escalators) and in support areas (e.g., distribution centers, technology) and fixtures in support areas are depreciated over 3 to 15 years. Leasehold improvements are amortized over the shorter of their estimated useful lives or their related lease terms, generally ranging from 10 to 20 years. Internally generated computer software is amortized over 3 to 10 years. Generally, no estimated salvage value at the end of the useful life of the assets is considered.

- When constructing stores, the Company receives allowances from landlords. If the landlord is determined to be the primary beneficiary of the property, then the portion of those allowances attributable to the property owned by the landlord is considered to be a deferred rent liability, whereas the corresponding capital expenditures related to that store are considered to be prepaid rent. Allowances in excess of the amounts attributable to the property owned by the landlord are considered improvement allowances and are recorded as deferred rent liabilities that are amortized over the life of the lease. Capital expenditures are also reduced when the Company receives cash and allowances from merchandise vendors to fund the construction of vendor shops.

- To the extent the Company remodels or otherwise replaces or disposes of property and equipment prior to the end of their assigned depreciable lives, the Company could realize a loss or gain on the disposition. To the extent assets continue to be used beyond their assigned depreciable lives, no depreciation expense is being realized. The Company reassesses the depreciable lives in an effort to reduce the risk of significant losses or gains at disposition and utilization of assets with no depreciation charges. The reassessment of depreciable lives involves utilizing historical remodel and disposition activity and forward−looking capital expenditure plans.

- Recoverability of the carrying value of store assets is assessed upon the occurrence of certain events (e.g., opening a new store near an existing store or announcing plans for a store closing) and, absent certain events, annually. The recoverability assessment requires judgment and estimates for future store generated cash flows. The underlying estimates for cash flows include estimates for future sales, gross margin rates, inflation and store expenses. During 2006, the Company recorded $6.1 million in impairment charges in the normal course of business. In addition, the Company recorded a $6.4 million charge primarily due to lease termination costs related to store closings. There are several stores in which current cash flows are not adequate to recover the carrying value of the store assets. However, the Company believes that estimated sales growth and gross margin improvement will enhance the cash flows of these stores such that the carrying value of the store assets will be recovered. Generally these stores were recently opened and require a two to five year period to develop the customer base to attain the required cash flows. To the extent management's estimates for sales growth and gross margin improvement are not realized, future annual assessments could result in impairment charges.

***LEASES***

The Company leases stores, distribution centers, and administrative facilities under operating leases. Store lease agreements generally include rent holidays, rent escalation clauses and contingent rent provisions for percentage of sales in excess of specified levels. Most of the Company's lease agreements include renewal periods at the Company's option. The Company recognizes rent holiday periods and scheduled rent increases on a straight−line basis over the lease term beginning with the date the Company takes possession of the leased space and includes such rent expense in Store Pre−Opening Costs. The Company records tenant improvement allowances and rent holidays as deferred rent liabilities on the consolidated balance sheets and amortizes the deferred rent over the terms of the lease to rent expense in the consolidated statements of income. The Company records rent liabilities on the consolidated balance sheets for contingent percentage of sales lease provisions when the Company determines that it is probable that the specified levels will be reached during the fiscal year.

***INCOME AND OTHER TAXES***

The majority of the Company's deferred tax assets at February 3, 2007 consist of federal and state net operating loss carryforwards that will expire between 2007 and 2026. During 2006 the valuation allowance against net operating loss carryforwards was reduced based on projections of future profitability. At February 3, 2007 the Company believes that it will be sufficiently profitable during the periods from 2007 to 2026 to utilize all of its federal NOLs and a significant portion of its state NOLs. To the extent management's estimates of future taxable income by jurisdiction are greater than or less than management's current estimates, future increases or decreases in the benefit for net operating losses could occur.

The Company is routinely under audit by federal, state and local authorities in the areas of income taxes and the remittance of sales and use taxes. Audit authorities may question the timing and amount of deductions, the allocation of income among various tax jurisdictions and compliance with federal, state and local tax laws. In evaluating the exposure associated with various tax filing positions, the Company often accrues for exposures related to uncertain tax positions.

During 2006, the Company concluded a federal income tax examination for the 2003 and 2004 tax years and concluded a number of state income tax examinations as well. The Company decreased the amount previously accrued for exposures related to uncertain tax positions by $10.2 million.

During 2004, the Company recorded a benefit of $4.6 million related to the expiration of the statute of limitations with respect to certain tax examination periods which was recorded as a credit to Shareholder's Equity in accordance with Statement of Position 90−7 "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code." In addition, an increase to the reserve for tax exposures of $2.6 million was recorded as an income tax expense for additional exposures.

At February 3, 2007, the Company believes it has appropriately accrued for exposures related to uncertain tax positions. To the extent the Company were to prevail in matters for which accruals have been established or be required to pay amounts in excess of reserves, the Company's effective tax rate in a given financial statement period may be materially impacted. At February 3, 2007, the Company's two open tax years were not under examination by the Internal Revenue Service while certain state examinations were ongoing.

***PENSION PLANS***

Pension expense is based on information provided by outside actuarial firms that use assumptions provided by the Company's management to estimate the total benefits ultimately payable to associates and allocates this cost to service periods. The actuarial assumptions used to calculate pension costs are reviewed annually. The pension plans are valued annually on November 1st. The projected unit credit method is utilized in recognizing the pension liabilities.

In September 2006, the FASB issued SFAS No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS No. 158"). The Company adopted SFAS No. 158 prospectively on February 3, 2007. This Statement requires the Company to recognize an asset or liability for the overfunded or underfunded status of its pension and other postretirement benefit plans. SFAS No. 158 requires the Company to recognize all unrecognized prior service costs and credits and unrecognized actuarial gains and losses in accumulated other comprehensive income ("AOCI"), net of tax. Such amounts will be adjusted as they are subsequently recognized as components of net periodic benefit cost or income pursuant to the current recognition and amortization provisions.

Upon adoption of SFAS No. 158, the Company recorded a pension asset of $4.6 million and eliminated the prepaid pension asset of $47.7 million. Based on the funded status of the defined benefit pension and postretirement benefit plans as of February 3, 2007, the Company also recorded a net decrease in AOCI of $26.0 million. The adoption of SFAS No. 158 on February 3, 2007 had no impact on the Company's earnings.

Pension assumptions are based upon management's best estimates, after consulting with outside investment advisors and actuaries, as of the annual measurement date.

- The assumed discount rate utilized is based upon pension discount curves and bond portfolio curves over a duration similar to the plan's liabilities as of the measurement date. The discount rate is utilized principally in calculating the Company's pension obligation, which is represented by the Accumulated Benefit Obligation (ABO) and the Projected Benefit Obligation (PBO) and in calculating net pension expense. At November 1, 2006, the discount rate was 5.50%. To the extent the discount rate increases or decreases, the Company's ABO is decreased or increased, respectively. The estimated effect of a 0.25% change in the discount rate is $3.0 million on the ABO and $0.1 million on annual pension expense. To the extent the ABO increases, the after−tax effect of such increase serves to reduce Other Comprehensive Income and Shareholders' Equity.

- The assumed expected long−term rate of return on assets is the weighted average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the PBO. It is the Company's policy to invest approximately 65% of the pension fund assets in equities, 30% in fixed income securities and 5% in real estate. This expected average long−term rate of return on assets is based principally on the advice of the Company's outside investment advisors. This rate is utilized principally in calculating the expected return on plan assets component of the annual pension expense. To the extent the actual rate of return on assets realized over the course of a year is greater than the assumed rate, that year's annual pension expense is not affected. Rather, this gain reduces future pension expense over a period of approximately 15 to 20 years. To the extent the actual rate of return on assets is less than the assumed rate, that year's annual pension expense is likewise not affected. Rather, this loss increases pension expense over approximately 15 to 20 years. During 2006 and 2005, the Company utilized 8.0% and 7.5%, respectively, as the expected long−term rate of return on assets.

- The assumed average rate of compensation increases is the average annual compensation increase expected over the remaining employment periods for the participating employees. This rate is estimated to be 4% for the periods following November 1, 2006 and is utilized principally in calculating the PBO and annual pension expense. The estimated effect of a 0.25% change in the assumed rate of compensation increases would not be material to the PBO or annual pension expense.

***INFLATION AND DEFLATION***

Inflation and deflation affect the costs incurred by the Company in its purchase of merchandise and in certain components of its SG&A expenses. The Company attempts to offset the effects of inflation, which has occurred in recent years in SG&A, through price increases and control of expenses, although the Company's ability to increase prices is limited by competitive factors in its markets. The Company attempts to offset the effects of merchandise deflation, which has occurred in recent years, through control of expenses.

***SEASONALITY***

The Company's business, like that of most retailers, is subject to seasonal influences, with a significant portion of net sales and net income realized during the second half of the fiscal year, which includes the holiday selling season. In light of these patterns, SG&A expenses are typically higher as a percentage of net sales during the first three fiscal quarters of each year, and working capital needs are greater in the last two fiscal quarters of each year. The increases in working capital needs during the fall season have typically been financed with cash flow from operations and borrowings under the Company's revolving credit agreement. Generally, more than 30% of the Company's sales are generated during the fourth quarter and a large portion of its operating income is generated during the fall season.

***NEW ACCOUNTING PRONOUNCEMENTS***

In July 2006, the FASB issued Interpretation 48 ("FIN 48") Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109, Accounting for Income Taxes. This interpretation clarifies the application of Statement 109 by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements. For a benefit to be recognized, a tax position must be more−likely−than−not to be sustained upon examination by taxing authorities. The benefit to be recognized for a tax position that meets the more−likely−than−not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. FIN 48 also provides guidance on derecognition, classification of interest and penalties, accounting in interim periods, and disclosure. The Company will adopt FIN 48 as of February 4, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded as an adjustment to shareholders' equity in the first quarter of 2007. The adoption of FIN 48 is not expected to have a material impact on the Company's consolidated financial statements. The Company currently anticipates that it will record an adjustment to increase shareholders' equity by $30 to $40 million.

The FASB is contemplating an amendment to SFAS No. 128, "Earnings Per Share," that would require the Company to ignore the cash presumption of net share settlement and to assume share settlement for purposes of calculating diluted earnings per share. Although the Company is now required to ignore the contingent conversion provision on its convertible notes under EITF 04−08, it can still presume that it will satisfy the net share settlement upon conversion of the notes in cash, and thus exclude the effect of the conversion of the notes in its calculation of dilutive earnings per share. If and when the FASB amends SFAS No. 128, the effect of the changes would require the Company to use the if−converted method in calculating dilutive earnings per share except when the effect would be anti−dilutive. The effect of adopting the amendment to SFAS No. 128 would increase the number of shares in the Company's dilutive calculation by 19,219 shares.

During September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or a liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under SFAS No. 157, fair value measurements would be separately disclosed by level within the fair value hierarchy effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this Statement and does not expect it to be material.

On September 29, 2006, the FASB issued SFAS No. 158. The Company adopted SFAS No. 158 prospectively on February 3, 2007. SFAS No. 158 requires an employer that sponsors one or more defined benefit pension plans or other postretirement plans to 1) recognize the funded status of a plan, measured as the difference between plan assets at fair value and the benefit obligation, in the balance sheet; 2) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost; 3) measure defined benefit plan assets and obligations as of the date of the employer's fiscal year−end balance sheet; and 4) disclose in the notes to the financial statements additional information about the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations. The adoption of SFAS No. 158 did not have a material effect on the Company's results of operations or financial position for the year ended February 3, 2007. Additionally, SFAS No. 158 will require the Company to change the measurement date for the assets and liabilities of its employee benefit plans from November 1 to the Company's fiscal year end beginning with the year ending January 31, 2009.

***RELATED PARTY TRANSACTIONS***

A summary of the Company's related party transactions is included in Item 13, Certain Relationships and Related Transactions, in this Form 10−K.

***FORWARD−LOOKING INFORMATION***

The information contained in this Form 10−K that addresses future results or expectations is considered "forward−looking" information within the definition of the Federal securities laws. Forward−looking information in this document can be identified through the use of words such as "may," "will," "intend," "plan," "project," "expect," "anticipate," "should," "would," "believe," "estimate," "contemplate," "possible," and "point." The forward−looking information is premised on many factors, some of which are outlined below. Actual consolidated results might differ materially from projected forward−looking information if there are any material changes in management's assumptions.

The forward−looking information and statements are or may be based on a series of projections and estimates and involve risks and uncertainties. These risks and uncertainties include such factors as: the level of consumer spending for apparel and other merchandise carried by the Company and its ability to respond quickly to consumer trends; adequate and stable sources of merchandise; the competitive pricing environment within the retail sector; the effectiveness of planned advertising, marketing, and promotional campaigns; favorable customer response to relationship marketing efforts of proprietary credit card loyalty programs; appropriate inventory management; effective expense control; successful operation of the Company's proprietary credit card strategic alliance with HSBC Bank Nevada, N.A.; geo−political risks; changes in interest rates; the outcome of the formal investigation by the Securities and Exchange Commission and the inquiry the Company understands has been commenced by the Office of the United States Attorney for the Southern District of New York into the matters that were the subject of the investigations conducted during 2004 and 2005 by the Audit Committee of the Company's Board of Directors and any related matters that may be under investigation or the subject of inquiry; the ultimate amount of reimbursement to vendors of improperly collected markdown allowances; the ultimate impact of improper timing of recording of inventory markdowns; and the ultimate impact of incorrect timing of recording of vendor markdown allowances. For additional information regarding these and other risk factors, please refer to Item 1A of Part I in this Form 10−K for the fiscal year ended February 3, 2007 filed with the SEC, which may be accessed via EDGAR through the Internet at *www.sec.gov.*

Management undertakes no obligation to correct or update any forward−looking statements, whether as a result of new information, future events, or otherwise. Persons are advised, however, to consult any further disclosures management makes on related subjects in its reports filed with the SEC and in its press releases.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

The Company's exposure to market risk primarily arises from changes in interest rates and the U.S. equity and bond markets. The effects of changes in interest rates on earnings generally have been small relative to other factors that also affect earnings, such as sales and operating margins. The Company seeks to manage exposure to adverse interest rate changes through its normal operating and financing activities, and if appropriate, through the use of derivative financial instruments. Such derivative instruments can be used as part of an overall risk management program in order to manage the costs and risks associated with various financial exposures. The Company does not enter into derivative instruments for trading purposes, as clearly defined in its risk management policies. The Company is exposed to interest rate risk primarily through its borrowings, and derivative financial instrument activities, which are described in Notes 2 and 7 to the Consolidated Financial Statements appearing in Item 8 of this Form 10−K.

During 2004 the Company terminated all remaining interest rate swap agreements resulting in net losses. When combined with net gains from other previously cancelled interest rate swap agreements, the Company had total unamortized net losses of $350 thousand and $584 thousand at February 3, 2007 and January 28, 2006, respectively, that are being amortized as a component of interest expense through 2010.

Based on the Company's market risk sensitive instruments outstanding at February 3, 2007, the Company has determined that there was no material market risk exposure to the Company's consolidated financial position, results of operations, or cash flows as of such date.

**Item 8. Financial Statements and Supplementary Data.**

Information called for by this item is set forth in the Company's Consolidated Financial Statements and supplementary data contained in this report beginning on page F−1.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

**DISCLOSURE CONTROLS AND PROCEDURES**

Under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and Chief Accounting Officer, the Company conducted an evaluation of the effectiveness of its disclosure controls and procedures (as such term is defined in Rules 13a−15(e) and 15d−15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this report. Based on this evaluation, the Company’s Chief Executive Officer and Chief Accounting Officer concluded that the Company’s disclosure controls and procedures were effective as of such date. The Company’s disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Accounting Officer, to allow timely discussions regarding required disclosure.

**MANAGEMENT’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a−15(f) and 15d−15(f). The Company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision−making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and Chief Accounting Officer, the Company conducted an evaluation of the effectiveness of the design and operation of the Company’s internal control over financial reporting as of the end of the period based on criteria set forth in the *Internal Control−Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on the management’s assessment, management believes that, as of the end of the period, the Company’s internal control over financial reporting was effective “at the reasonable assurance level” based on those criteria.

Management’s assessment of the effectiveness of the Company’s internal control over financial reporting as of the end of the period has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There were no changes in the Company's internal controls over financial reporting that occurred during the quarter ended February 3, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

Not applicable.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance.

The information set forth under the captions "Election of Directors," "Corporate Governance —Board Practices," and "Corporate Governance — Audit Committee" in the Saks Incorporated Proxy Statement for the 2007 Annual Meeting of Shareholders to be held on June 6, 2007 (the "Proxy Statement"), is incorporated herein by reference.

The information required under this item with respect to the Company's Executive Officers is incorporated by reference from Item 1C of this report under "Executive Officers of the Registrant."

The information set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement, with respect to compliance with Section 16(a) by the Company's Directors, Executive Officers and persons who own more than 10% of the Company's Common Stock, is incorporated herein by reference.

### Item 11. Executive Compensation.

The information in the Proxy Statement set forth under the captions "Executive Compensation," "Director Compensation," and "Corporate Governance — Human Resources and Compensation Committee" is incorporated herein by reference, except that the Report of the Human Resources and Compensation Committee of the Board of Directors, included as part of the caption "Executive Compensation," shall not be deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C, or to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information set forth under the caption "Outstanding Voting Securities" in the Proxy Statement, with respect to security ownership of certain beneficial owners and management, is incorporated herein by reference.

The information set forth under the caption "Executive Compensation — Equity Compensation Plan Information" in the Proxy Statement, with respect to equity compensation plans approved and not approved by security holders, is incorporated herein by reference.

### Item 13. Certain Relationships and Related Transactions, and Director Independence

The information set forth under the captions "Certain Transactions and Other Matters," with respect to certain relationships and related transactions, and "Corporate Governance — Director Independence," with respect to the independence of the Company's independent directors, is incorporated herein by reference.

### Item 14. Principal Accountant Fees and Services.

The information set forth under the caption "Ratification of Appointment of Registered Public Accounting Firm — PricewaterhouseCoopers LLP Fees and Services in 2006 and 2005" in the Proxy Statement is incorporated herein by reference.

## PART IV

**Item 15. Exhibits and Financial Statement Schedules.**

(a) The following documents are filed as a part of this report:

(1) Financial Statements — The financial statements listed on page F−1 herein.

(2) Financial Statement Schedule — The financial statement schedule listed on page F−1 herein.

(3) Exhibits — The exhibits listed on the accompanying Index to Exhibits appearing at page E−1.

(b) The exhibits listed on the accompanying Index to Exhibits appearing at page E−1 are filed as exhibits to this report.

(c) Financial Statement Schedule

Schedule II — Valuation and Qualifying Accounts

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are either included in the financial statements or notes thereto or are not required or are not applicable and therefore have been omitted.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on April 2, 2007.

SAKS INCORPORATED

By: /s/ KEVIN G. WILLS
**Kevin G. Wills**
**Executive Vice President of Finance and**
**Chief Accounting Officer**

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on April 2, 2007.

/s/ STEPHEN I. SADOVE
**Stephen I. Sadove**
**Chief Executive Officer**
**Director**
***Principal Executive Officer***

/s/ KEVIN G. WILLS
**Kevin G. Wills**
**Executive Vice President of Finance and**
**Chief Accounting Officer**
***Principal Financial and Accounting Officer***

/s/ R. BRAD MARTIN
**R. Brad Martin**
**Chairman of the Board**

/s/ RONALD DE WAAL
**Ronald de Waal**
**Vice Chairman of the Board**

/s/ STANTON J. BLUESTONE
**Stanton J. Bluestone**
**Director**

/s/ ROBERT B. CARTER
**Robert B. Carter**
**Director**

/s/ JULIUS W. ERVING
**Julius W. Erving**
**Director**

[Table of Contents](#)

[Index to Financial Statements](#)

/s/ Michael S. Gross

**Michael S. Gross**
**Director**

/s/ Donald E. Hess

**Donald E. Hess**
**Director**

/s/ Marguerite S. Kondracke

**Marguerite S. Kondracke**
**Director**

/s/ Nora P. McAniff

**Nora P. McAniff**
**Director**

/s/ C. Warren Neel

**C. Warren Neel**
**Director**

/s/ Christopher J. Stadler

**Christopher J. Stadler**
**Director**

**FORM 10−K — ITEM 15(a)(3) AND 15(c)**

**SAKS INCORPORATED AND SUBSIDIARIES**

## EXHIBITS

| Exhibit No. | Description |
|---|---|
| 2.1 | Asset Purchase Agreement, dated as of April 28, 2005, between Saks Incorporated and Belk, Inc. (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on May 2, 2005) |
| 2.2 | Purchase Agreement, dated as of October 29, 2005, between Saks Incorporated and The Bon−Ton Stores, Inc. (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on November 3, 2005) |
| 2.3 | Amendment No. 1 to Purchase Agreement, dated as of February 16, 2006, between Saks Incorporated and The Bon−Ton Stores, Inc. (incorporated by reference form the Exhibits to the Form 8−K filed on February 21, 2006) |
| 2.4 | Stock Purchase Agreement, dated as of August 1, 2006, between Saks Incorporated and Belk, Inc. (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on August 7, 2006) |
| 3.1* | Amended and Restated Charter of Saks Incorporated |
| 3.2 | Amended and Restated Bylaws of Saks Incorporated (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended February 1, 2003) |
| 4.1 | Indenture, dated as of November 9, 1998, among Saks Incorporated, the Subsidiary Guarantors, and The First National Bank of Chicago, as trustee (8 $^{1}/_{4}$% Notes due 2008) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on November 19, 1998) |
| 4.2 | Indenture, dated as of December 2, 1998, among Saks Incorporated, the Subsidiary Guarantors, and The First National Bank of Chicago, as trustee (7 $^{1}/_{2}$% Notes due 2010) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on December 4, 1998) |
| 4.3 | Indenture, dated as of February 17, 1999, among Saks Incorporated, the Subsidiary Guarantors, and The First National Bank of Chicago, as trustee (7 $^{3}/_{8}$% Notes due 2019) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on February 19, 1999) |
| 4.4 | Indenture, dated as of October 4, 2001, among Saks Incorporated, the Subsidiary Guarantors, and Bank One Trust Company, National Association, as trustee (9 $^{7}/_{8}$% Notes due 2011) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on October 11, 2001) |
| 4.5 | Registration Rights Agreement, dated as of July 8, 1996, between Proffitt's, Inc. and Parisian, Inc. (incorporated by reference from the Exhibits to the Form S−4/A Registration Statement No. 333−09043 of Proffitt's, Inc. filed on August 16, 1996) |
| 4.6 | Registration Rights Agreement, dated as of July 4, 1998, between Proffitt's, Inc. and specified stockholders of Saks Holdings, Inc. (incorporated by reference from the Exhibits to the Form 8−K of Proffitt's, Inc. filed on July 8, 1998) |
| 4.7 | Second Amended and Restated Rights Agreement, dated as of October 4, 2004, between Saks Incorporated and The Bank of New York, as Rights Agent (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on October 10, 2004) |

| Exhibit No. | Description |
|---|---|
| 4.8 | Indenture, dated as of December 8, 2003, among Saks Incorporated, the Subsidiary Guarantors named therein, and the Bank of New York, as Trustee (7% Notes due 2013) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on December 11, 2003) |
| 4.9 | Registration Rights Agreement, dated as of December 8, 2003, among Saks Incorporated, certain of its subsidiaries named therein, Citigroup Global Markets Inc., Goldman, Sachs & Company, Wachovia Capital Markets, LLC, Banc One Capital Markets, Inc. and ABN AMRO Incorporated (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on December 11, 2003) |
| 4.10 | Indenture, dated as of March 23, 2004, between Saks Incorporated, the Subsidiary Guarantors named therein, and The Bank of New York Trust Company, N.A., as trustee (2.00% Convertible Senior Notes due 2024) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on March 26, 2004) |
| 4.11 | Registration Rights Agreement, dated as of March 23, 2004, among Saks Incorporated, certain subsidiaries of Saks Incorporated named therein, Goldman, Sachs & Co. and Citigroup Global Markets Inc., as representatives of the purchasers (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on March 26, 2004) |
| 4.12 | Supplemental Indenture, dated as of July 1, 2005, among Saks Incorporated, the Subsidiary Guarantors named therein, and The Bank of New York Trust Company, N.A., as trustee (2.00% Convertible Senior Notes due 2024) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on July 6, 2005) |
| 4.13 | Fourth Supplemental Indenture, dated as of July 1, 2005, among Saks Incorporated, the Subsidiary Guarantors named therein, and JPMorgan Chase Bank, N.A., as trustee (9 7/8% Notes due 2011) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on July 6, 2005) |
| 4.14 | Seventh Supplemental Indenture, dated as of July 1, 2005, among Saks Incorporated, the Subsidiary Guarantors named therein, and JPMorgan Chase Bank, N.A., as trustee (8 1/4% Notes due 2008) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on July 6, 2005) |
| 4.15 | Seventh Supplemental Indenture, dated as of July 19, 2005, among Saks Incorporated, the Subsidiary Guarantors named therein, and J.P. Morgan Trust Company, National Association, as trustee (7 1/2% Notes due 2010) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on July 21, 2005) |
| 4.16 | Second Supplemental Indenture, dated as of July 19, 2005, among Saks Incorporated, the Subsidiary Guarantors named therein, and The Bank of New York Trust Company, N.A., as trustee (7% Notes due 2013) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on July 21, 2005) |
| 4.17 | Seventh Supplemental Indenture, dated as of July 19, 2005, among Saks Incorporated, the Subsidiary Guarantors named therein, and J.P. Morgan Trust Company, National Association, as Trustee (7 3/8% Notes due 2019) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on July 21, 2005) |
| 4.18 | Instrument of Resignation, Appointment and Acceptance, dated as of August 22, 2005, among Saks Incorporated, J.P. Morgan Trust Company, National Association, and The Bank Of New York Trust Company, N.A. (8 1/4% Notes due 2008) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on August 25, 2005) |

| Exhibit No. | Description |
|---|---|
| 4.19 | Instrument of Resignation, Appointment and Acceptance, dated as of August 22, 2005, among Saks Incorporated, J.P. Morgan Trust Company, National Association, and The Bank Of New York Trust Company, N.A. (7 $^{1}/_{2}$% Notes due 2010) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on August 25, 2005) |
| 4.20 | Instrument of Resignation, Appointment and Acceptance, dated as of August 22, 2005, among Saks Incorporated, J.P. Morgan Trust Company, National Association, and The Bank Of New York Trust Company, N.A. (9 $^{7}/_{8}$% Notes due 2011) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on August 25, 2005) |
| 4.21 | Instrument of Resignation, Appointment and Acceptance, dated as of August 22, 2005, among Saks Incorporated, J.P. Morgan Trust Company, National Association, and The Bank Of New York Trust Company, N.A. (7 $^{3}/_{8}$% Notes due 2019) (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on August 25, 2005) |
| 10.1 | Amended and Restated Credit Agreement, dated as of November 26, 2003, among Saks Incorporated, as borrower, Fleet Retail Group, Inc., as Agent, and the other financial institutions party thereto, as lenders (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on March 16, 2004) |
| 10.2 | First Amendment and Waiver to Credit Agreement and Second Amendment to Security Agreement, dated as of June 6, 2005, among Saks Incorporated, as borrower; Fleet Retail Group, Inc., as Agent; Citicorp North America, Inc., as Syndication Agent; Wachovia Bank, National Association, JPMorgan Chase Bank and General Electric Capital Corporation, as Co−Documentation Agents; and the other financial institutions party thereto, as lenders (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended January 29, 2005) |
| 10.3 | Second Amendment and Waiver to Credit Agreement, dated as of January 26, 2006, among Saks Incorporated, as borrower; Fleet Retail Group, Inc., as Agent; Citicorp North America, Inc., as Syndication Agent; Wachovia Bank, National Association, JPMorgan Chase Bank, N.A. and General Electric Capital Corporation, as Co−Documentation Agents; and the other financial institutions party thereto, as lenders (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on February 1, 2006) |
| 10.4 | Third Amendment and Waiver to Credit Agreement, dated as of September 22, 2006, among Saks Incorporated, as borrower; Bank of America, N.A. (as successor in interest to Fleet Retail Group, LLC (f/k/a Fleet Retail Group, Inc.)), as Agent; Citicorp North America, Inc., as Syndication Agent; Wachovia Bank, National Association, JPMorgan Chase Bank, N.A. and General Electric Capital Corporation, as Co−Documentation Agents; and the other financial institutions party thereto, as lenders (incorporated by reference from the Exhibits to the Form 10−Q of Saks Incorporated for the quarterly period ended October 28, 2006) |
| 10.5 | Supplemental Transaction Agreement, dated as of April 14, 2003, among Saks Incorporated, National Bank of the Great Lakes, Saks Credit Corporation, Household Finance Corporation, and Household Bank (SB), N.A. (incorporated by reference from the Exhibits from the Form 8−K of Saks Incorporated filed on April 29, 2003) |
| 10.6 | Servicing Agreement, dated as of April 15, 2003, between Jackson Office Properties, Inc., as successor to McRae’s, Inc., and Household Corporation (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on April 29, 2003) |

| Exhibit No. | Description |
|---|---|
| 10.7 | Program Agreement, dated as of April 15, 2003, among Saks Incorporated, Jackson Office Properties, Inc. (as successor to McRae's, Inc.), and Household Bank (SB), N.A. (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on April 29, 2003) |
| 10.8 | Amended and Restated Transition Service Agreement, dated as of March 10, 2006, between Saks Incorporated and The Bon−Ton Stores, Inc. (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on March 10, 2006) |
| 10.9 | Transition Service Agreement, dated as of October 2, 2006, between Saks Incorporated and Belk, Inc. (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on October 6, 2006) |
| MANAGEMENT CONTRACTS, COMPENSATORY PLANS OR ARRANGEMENTS, ETC. | |
| 10.10 | Saks Incorporated Amended and Restated Employee Stock Purchase Plan (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended February 2, 2002) |
| 10.11 | Saks Incorporated Amended and Restated 1994 Long−Term Incentive Plan (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended January 30, 1999) |
| 10.12 | Saks Incorporated Amended and Restated 1997 Stock−Based Incentive Plan (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended February 3, 2001) |
| 10.13 | Form of Stock Option Agreement Pursuant to the Saks Incorporated Amended and Restated 1997 Stock−Based Incentive Plan (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended January 29, 2005) |
| 10.14 | Saks Incorporated 2004 Long−Term Incentive Plan (incorporated by reference from Exhibit B to the proxy statement of Saks Incorporated filed on April 28, 2004) |
| 10.15 | Saks Incorporated 401(k) Retirement Plan (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended January 30, 1999) |
| 10.16 | Trust Agreement for the Saks Incorporated 401(k) Retirement Plan (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended January 30, 1999) |
| 10.17 | Saks Incorporated Deferred Compensation Plan (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended February 1, 2003) |
| 10.18 | Carson Pirie Scott & Co. 1993 Stock Incentive Plan as Amended and Restated as of March 19, 1997 (incorporated by reference from the Exhibits to the Form 10−K of Carson Pirie Scott & Co. for the fiscal year ended February 2, 1997) |
| 10.19 | Carson Pirie Scott & Co. 1996 Long−Term Incentive Plan (incorporated by reference from the Exhibits to the Form 10−K of Carson Pirie Scott & Co. for the fiscal year ended February 2, 1997) |
| 10.20 | Saks Holdings, Inc. 1996 Management Stock Incentive Plan, dated as of February 1, 1996 (incorporated by reference from the Exhibits to the Form S−1 of Saks Holdings, Inc. Registration Statement No. 333−2426) |

| Exhibit No. | Description |
|---|---|
| 10.21 | Amendment to the Saks Holdings, Inc. 1996 Management Stock Incentive Plan, dated as of February 1, 1996 (incorporated by reference from the Exhibits to the Form S−1 of Saks Holdings, Inc. Registration Statement No. 333−2426) |
| 10.22 | Form of Stock Option Agreement Pursuant to the Saks Holdings, Inc. 1996 Management Stock Incentive Plan, dated February 1, 1996 (incorporated by reference from the Exhibits to the Form S−1 of Saks Holdings, Inc. Registration No. 333−2426) |
| 10.23 | Saks Incorporated 2003 Senior Executive Bonus Plan (incorporated by reference from Attachment A to the Saks Incorporated Proxy Statement for the 2003 Annual Meeting of Shareholders) |
| 10.24* | Amended and Restated 2000 Change of Control and Material Transaction Severance Plan |
| 10.25 | Restricted Stock Agreement, dated as of May 18, 2005, between Kevin Wills and Saks Incorporated and the Supplement to the Restricted Stock Agreement, dated May 18, 2005 (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on May 18, 2005) |
| 10.26 | Form of Performance Share Agreement, dated as of June 16, 2004, between Saks Incorporated and each recipient (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on June 29, 2005) |
| 10.27 | Supplement to Performance Share Agreement, dated as of June 27, 2005, between Saks Incorporated and R. Brad Martin (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on June 29, 2005) |
| 10.28 | Form of Supplement to Performance Share Agreement, dated as of June 27, 2005, between Saks Incorporated and each recipient (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on June 29, 2005) |
| 10.29 | Form of Restricted Stock Agreement with respect to the Saks Incorporated 2004 Long−Term Incentive Plan (incorporated by reference from the Exhibits to the Form 10−Q of Saks Incorporated for the quarterly period ended April 30, 2005) |
| 10.30 | Form of Supplement to Restricted Stock Agreement with respect to the Saks Incorporated 2004 Long−Term Incentive Plan (incorporated by reference from the Exhibits to the Form 10−Q of Saks Incorporated for the quarterly period ended April 30, 2005) |
| 10.31* | Form of Stock Option Agreement with respect to the Saks Incorporated 2004 Long−Term Incentive Plan |
| 10.32 | Form of Indemnification Agreement, dated as of April 5, 2006, between Saks Incorporated, and each of the counterparties thereto (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended January 28, 2006) |
| 10.33 | Amended and Restated Employment Agreement, dated as of December 8, 2004, between R. Brad Martin and Saks Incorporated (incorporated by reference from the Exhibit 10.1 to the Form 10−Q of Saks Incorporated for the quarterly period ended October 30, 2004) |
| 10.34 | Employment Agreement, dated as of January 7, 2002, between Saks Incorporated and Stephen I. Sadove, Vice Chairman of Saks Incorporated (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended February 2, 2002) |

| Exhibit No. | Description |
|---|---|
| 10.35 | Employment Agreement, dated as of June 8, 2006, between Saks Incorporated and James A. Coggin, President and Chief Administrative Officer (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on June 9, 2006) |
| 10.36 | Employment Agreement, dated as of January 9, 2004, between Jackson Office Properties, Inc. (successor in interest to McRae's, Inc.) and Ronald L. Frasch, President and Chief Merchandising Officer (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on February 6, 2007) |
| 10.37 | Employment Agreement, dated as of June 8, 2006, between Saks Incorporated and Douglas E. Coltharp, Executive Vice President and Chief Financial Officer (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on June 9, 2006) |
| 10.38 | Letter agreement (relating to Employment Agreement), dated as of October 23, 2006, between Saks Incorporated and Douglas E. Coltharp, Executive Vice President and Chief Financial Officer (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on October 23, 2006) |
| 10.39 | Employment Agreement, dated as of June 8, 2006, between Saks Incorporated and Charles J. Hansen, Executive Vice President and General Counsel (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on June 9, 2006) |
| 10.40 | Letter agreement (relating to Employment Agreement), dated as of October 23, 2006, between Saks Incorporated and Charles J. Hansen, Executive Vice President and General Counsel (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on October 23, 2006) |
| 10.41 | Employment Agreement, dated as of June 8, 2006, between Saks Incorporated and Kevin G. Wills, Executive Vice President of Finance and Chief Accounting Officer (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on June 9, 2006) |
| 10.42 | Letter agreement (relating to Employment Agreement), dated as of October 23, 2006, between Saks Incorporated and Kevin G. Wills, Executive Vice President of Finance and Chief Accounting Officer (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on October 23, 2006) |
| 10.43 | Employment Agreement, dated as of April 5, 2006, between Saks Incorporated and Charles G. Tharp, Executive Vice President−Human Resources (incorporated by reference from the Exhibits to the Form 10−K of Saks Incorporated for the fiscal year ended January 28, 2006) |
| 10.44 | Employment Agreement, dated as of September 15, 2006, between Saks Incorporated and Julia A. Bentley, Senior Vice President−Investor Relations and Communications (incorporated by reference from the Exhibits to the Form 8−K of Saks Incorporated filed on September 21, 2006) |
| 21.1* | Subsidiaries of the registrant |
| 23.1* | Consents of Independent Registered Public Accounting Firm |
| 31.1* | Certification of the principal executive officer of Saks Incorporated required by Rule 13a−14(a) or Rule 15d−14(a) of the Securities Exchange Act of 1934, as amended |

Table of Contents

Index to Financial Statements

| Exhibit No. | Description |
|---|---|
| 31.2* | Certification of the principal accounting officer of Saks Incorporated required by Rule 13a−14(a) or Rule 15d−14(a) of the Securities Exchange Act of 1934, as amended |
| 32.1* | Certification of principal executive officer of Saks Incorporated Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley Act of 2002 |
| 32.2* | Certification of the principal accounting officer of Saks Incorporated Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley Act of 2002 |
| 99.1* | Saks Incorporated Employee Stock Purchase Plan Financial Statements for the years ended December 31, 2006 and December 31, 2005 |

* Filed herewith

**SAKS INCORPORATED & SUBSIDIARIES**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**



All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Saks Incorporated:

We have completed integrated audits of Saks Incorporated's consolidated financial statements and of its internal control over financial reporting as of February 3, 2007, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Saks Incorporated (the Company) and its subsidiaries at February 3, 2007 and January 28, 2006, and the results of its operations and its cash flows for each of the three years in the period ended February 3, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), "Share−Based Payment", as of January 29, 2006 and as discussed in Note 9, the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", as of February 3, 2007.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of February 3, 2007 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 3, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Birmingham, AL

April 2, 2007

**SAKS INCORPORATED & SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

| (In Thousands, except per share amounts) | Year Ended February 3, 2007 | January 28, 2006 | January 29, 2005 |
|---|---|---|---|
| **NET SALES** | $ 2,940,003 | $ 2,778,333 | $ 2,766,977 |
| Cost of sales (excluding depreciation and amortization) | 1,804,294 | 1,754,833 | 1,681,297 |
| Gross margin | 1,135,709 | 1,023,500 | 1,085,680 |
| Selling, general and administrative expenses | 819,218 | 830,495 | 796,574 |
| Other operating expenses | | | |
| Property and equipment rentals | 114,718 | 109,000 | 106,677 |
| Depreciation and amortization | 128,522 | 133,556 | 130,131 |
| Taxes other than income taxes | 80,614 | 85,016 | 80,042 |
| Store pre−opening costs | 597 | 1,227 | 1,993 |
| Impairments and dispositions | 12,443 | (7,848) | 20,768 |
| **OPERATING LOSS** | (20,403) | (127,946) | (50,505) |
| Interest expense | (50,136) | (77,188) | (104,773) |
| Gain (loss) on extinguishment of debt | 7 | (29,375) | — |
| Other income, net | 28,407 | 7,705 | 4,048 |
| **LOSS BEFORE INCOME TAXES** | (42,125) | (226,804) | (151,230) |
| Benefit for income taxes | (34,783) | (93,161) | (71,024) |
| **LOSS FROM CONTINUING OPERATIONS** | (7,342) | (133,643) | (80,206) |
| **DISCONTINUED OPERATIONS:** | | | |
| Income from discontinued operations (including gain on disposal of $191,918, $156,010 and $0, respectively) | 193,377 | 321,443 | 235,468 |
| Provision for income taxes | 132,293 | 165,452 | 94,177 |
| **INCOME FROM DISCONTINUED OPERATIONS** | 61,084 | 155,991 | 141,291 |
| **NET INCOME** | $ 53,742 | $ 22,348 | $ 61,085 |
| Per share amounts — Basic | | | |
| Loss from continuing operations | $ (0.05) | $ (0.97) | $ (0.58) |
| Income from discontinued operations | $ 0.45 | $ 1.13 | $ 1.01 |
| Net income | $ 0.40 | $ 0.16 | $ 0.44 |
| Per share amounts — Diluted | | | |
| Loss from continuing operations | $ (0.05) | $ (0.97) | $ (0.58) |
| Income from discontinued operations | $ 0.45 | $ 1.13 | $ 1.01 |
| Net income | $ 0.40 | $ 0.16 | $ 0.44 |
| Weighted average common shares: | | | |
| Basic | 135,880 | 138,348 | 139,470 |
| Diluted | 135,880 | 138,348 | 139,470 |

The accompanying notes are an integral part of these consolidated financial statements.

**SAKS INCORPORATED & SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

| (In Thousands, except per share amounts) | February 3, 2007 | January 28, 2006 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 277,883 | $ 77,312 |
| Merchandise inventories | 785,302 | 807,211 |
| Other current assets | 146,893 | 165,085 |
| Deferred income taxes, net | 40,763 | 119,558 |
| Current assets — held for sale | — | 475,485 |
| **TOTAL CURRENT ASSETS** | 1,250,841 | 1,644,651 |
| **PROPERTY AND EQUIPMENT, NET OF DEPRECIATION** | 1,099,331 | 1,340,868 |
| **PROPERTY AND EQUIPMENT, NET OF DEPRECIATION — held for sale** | — | 436,412 |
| **GOODWILL AND INTANGIBLES, NET OF AMORTIZATION** | 324 | 181,644 |
| **GOODWILL AND INTANGIBLES, NET OF AMORTIZATION — held for sale** | — | 1,789 |
| **DEFERRED INCOME TAXES, NET** | 152,754 | 191,480 |
| **OTHER ASSETS** | 41,053 | 42,549 |
| **OTHER ASSETS — held for sale** | — | 11,332 |
| **TOTAL ASSETS** | $ 2,544,303 | $ 3,850,725 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable | $ 231,038 | $ 190,064 |
| Accrued expenses | 318,188 | 372,821 |
| Accrued compensation and related items | 68,267 | 68,228 |
| Sales taxes payable | 8,620 | 9,066 |
| Current portion of long−term debt | 236,667 | 7,803 |
| Current liabilities — held for sale | — | 197,068 |
| **TOTAL CURRENT LIABILITIES** | 862,780 | 845,050 |
| **LONG−TERM DEBT** | 450,010 | 688,080 |
| **LONG−TERM DEBT — held for sale** | — | 34,656 |
| **OTHER LONG−TERM LIABILITIES** | 135,374 | 203,583 |
| **LONG−TERM LIABILITIES — held for sale** | — | 79,973 |
| **COMMITMENTS AND CONTINGENCIES** | — | — |
| **SHAREHOLDERS' EQUITY** | | |
| Preferred stock — $1.00 par value; Authorized — 10,000 shares; Issued and outstanding — none | — | — |
| Common stock — $0.10 par value; Authorized — 500,000 shares; Issued and outstanding — 140,480 shares and 136,005 shares | 14,048 | 13,601 |
| Additional paid−in capital | 1,097,817 | 1,994,979 |
| Accumulated other comprehensive loss | (28,346) | (72,467) |
| Retained earnings | 12,620 | 63,270 |
| **TOTAL SHAREHOLDERS' EQUITY** | 1,096,139 | 1,999,383 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | $ 2,544,303 | $ 3,850,725 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

Index to Financial Statements

SAKS INCORPORATED & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| (In Thousands) | Common Stock Shares | Common Stock Amount | Additional Paid−In Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance at January 31, 2004 | 141,835 | $14,183 | $ 2,111,214 | $ 217,550 | $ (71,610) | $ 2,271,337 |
| Net income | | | | 61,085 | | 61,085 |
| Change in minimum pension liability | | | | | (15,208) | (15,208) |
| Comprehensive income | | | | | | 45,877 |
| Issuance of common stock | 2,714 | 272 | 27,699 | | | 27,971 |
| Income tax benefit related to employee stock plans | | | 8,450 | | | 8,450 |
| Income tax effect of NOL carryforwards | | | 71,023 | | | 71,023 |
| Decrease in tax valuation allowance | | | 4,586 | | | 4,586 |
| Dividend Paid | | | (47,838) | (237,713) | | (285,551) |
| Net activity under stock compensation plans | 1,769 | 177 | 13,720 | | | 13,897 |
| Convertible notes: | | | | | | |
| Hedge and call option | | | (25,043) | | | (25,043) |
| Income tax effect | | | 15,268 | | | 15,268 |
| Repurchase of common stock | (6,203) | (620) | (84,777) | | | (85,397) |
| Balance at January 29, 2005 | 140,115 | 14,012 | 2,094,302 | 40,922 | (86,818) | 2,062,418 |
| Net income | | | | 22,348 | | 22,348 |
| Change in minimum pension liability | | | | | 14,351 | 14,351 |
| Comprehensive income | | | | | | 36,699 |
| Issuance of common stock | 8,195 | 820 | 82,688 | | | 83,508 |
| Income tax benefit related to employee stock plans | | | 20,281 | | | 20,281 |
| Decrease in tax valuation allowance | | | 2,525 | | | 2,525 |
| Activity under stock compensation plans | 555 | 55 | 17,540 | | | 17,595 |
| Repurchase of common stock | (12,860) | (1,286) | (222,357) | | | (223,643) |
| Balance at January 28, 2006 | 136,005 | 13,601 | 1,994,979 | 63,270 | (72,467) | 1,999,383 |
| Net income | | | | 53,742 | | 53,742 |
| Elimination of NDSG minimum pension liability | | | | | 39,380 | 39,380 |
| Change in additional minimum pension liability | | | | | 30,757 | 30,757 |
| Comprehensive income | | | | | | 123,879 |
| Adoption of SFAS No. 158 | | | | | (26,016) | (26,016) |
| Issuance of common stock | 5,031 | 503 | 51,227 | | | 51,730 |
| Dividends Paid | | | (1,001,733) | (104,392) | | (1,106,125) |
| Income tax benefit related to employee stock plans | | | 13,470 | | | 13,470 |
| Activity under stock compensation plans | (146) | (11) | (5,712) | | | (5,723) |
| Stock−based compensation — stock options and restricted stock | | | 18,722 | | | 18,722 |
| Stock−based compensation — FAS 123R dividend adjustment | | | 33,350 | | | 33,350 |
| Repurchase of common stock | (450) | (45) | (6,486) | | | (6,531) |
| Balance at February 3, 2007 | 140,440 | $14,048 | $ 1,097,817 | $ 12,620 | $ (28,346) | $ 1,096,139 |

The accompanying notes are an integral part of these consolidated financial statements.

SAKS INCORPORATED & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In Thousands) | Year Ended February 3, 2007 | January 28, 2006 | January 29, 2005 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Net income | $ 53,742 | $ 22,348 | $ 61,085 |
| Income from discontinued operations | 61,084 | 155,991 | 141,291 |
| Loss from continuing operations | (7,342) | (133,643) | (80,206) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Gain (loss) on extinguishment of debt | (7) | 29,375 | — |
| Depreciation and amortization | 128,522 | 133,556 | 130,131 |
| Provision for employee stock compensation | 52,072 | 17,595 | 13,897 |
| Deferred income taxes | 93,987 | 37,262 | 6,744 |
| Impairments and dispositions | 12,443 | (7,848) | 20,768 |
| Excess tax benefit from stock−based compensation | (16,027) | — | — |
| Changes in operating assets and liabilities: | | | |
| Merchandise inventories | (142,817) | 67,772 | (54,867) |
| Other current assets | (11,056) | (39,699) | 15,300 |
| Accounts payable and accrued liabilities | 53,254 | (49,106) | (19,838) |
| Other operating assets and liabilities | (12,014) | (19,992) | 16,863 |
| Net Cash Provided By Operating Activities — Continuing Operations | 151,015 | 35,272 | 48,792 |
| Net Cash Provided By (Used In) Operating Activities — Discontinued Operations | (95,730) | 152,800 | 310,029 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | 55,285 | 188,072 | 358,821 |
| **INVESTING ACTIVITIES** | | | |
| Purchases of property and equipment | (123,679) | (130,124) | (96,013) |
| Proceeds from sale of property and equipment | 171 | 13,236 | 17,183 |
| Net Cash Used In Investing Activities — Continuing Operations | (123,508) | (116,888) | (78,830) |
| Net Cash Provided By (Used In) Investing Activities — Discontinued Operations | 1,307,025 | 514,599 | (97,642) |
| **NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES** | 1,183,517 | 397,711 | (176,472) |
| **FINANCING ACTIVITIES** | | | |
| Proceeds from issuance of convertible senior notes | — | — | 230,000 |
| Payments for hedge and call options associated with convertible notes | — | — | (25,043) |
| Payments on long−term debt and capital lease obligations | (7,371) | (621,316) | (149,152) |
| Excess tax benefit from stock−based compensation | 16,027 | — | — |
| Cash dividends paid | (1,095,025) | (795) | (283,127) |
| Purchases and retirements of common stock | (6,531) | (223,643) | (85,397) |
| Proceeds from issuance of common stock | 51,730 | 83,508 | 27,971 |
| Net Cash Used In Financing Activities — Continuing Operations | (1,041,170) | (762,246) | (284,748) |
| Net Cash Used In Financing Activities — Discontinued Operations | (149) | (241) | (6,370) |
| **NET CASH USED IN FINANCING ACTIVITIES** | (1,041,319) | (762,487) | (291,118) |
| **INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | 197,483 | (176,704) | (108,769) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 77,312 | 257,104 | 365,873 |
| **PLUS: CASH AND CASH EQUIVALENTS INCLUDED IN ASSETS HELD FOR SALE AT BEGINNING OF YEAR** | 3,088 | — | — |
| **LESS: CASH AND CASH EQUIVALENTS INCLUDED IN ASSETS HELD FOR SALE AT END OF YEAR** | | (3,088) | — |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 277,883 | $ 77,312 | $ 257,104 |

Non−cash investing and financing activities are further described in the accompanying notes.

The accompanying notes are an integral part of these consolidated financial statements.

**SAKS INCORPORATED & SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollar amounts in thousands, except per share amounts)**

**NOTE 1 — GENERAL**

**ORGANIZATION**

Saks Incorporated and its subsidiaries' (together the "Company") operations consist of Saks Fifth Avenue (SFA), Off Fifth, and Club Libby Lu. Previously, the Company also operated Saks Department Store Group ("SDSG"), which consisted of Proffitt's and McRae's ("Proffitt's") (sold to Belk, Inc. ("Belk") in July 2005), the Northern Department Store Group ("NDSG") (operated under the nameplates of Bergner's, Boston Store, Carson Pirie Scott, Herberger's and Younkers and sold to The Bon−Ton Stores, Inc. ("Bon−Ton") in March 2006), and Parisian (sold to Belk in October 2006). The sold businesses are presented as discontinued operations in the consolidated statements of income and the consolidated statements of cash flows for the current and prior year periods and are discussed below at "Discontinued Operations."

**DISCONTINUED OPERATIONS**

On July 5, 2005, Belk acquired from the Company for approximately $623,000 in cash substantially all of the assets directly involved in the Proffitt's business operations, plus the assumption of approximately $1,000 in capitalized lease obligations and the assumption of certain other ordinary course liabilities associated with the acquired assets. The assets sold included the real and personal property and inventory associated with 22 Proffitt's stores and 25 McRae's stores that generated fiscal 2004 revenues of approximately $784,000. The Company realized a net gain of $155,525 on the sale.

Upon the closing of the transaction, Belk entered into a Transition Services Agreement ("Proffitt's TSA") whereby the Company continued to provide certain back office services related to the Proffitt's operations. Beginning with the second quarter of 2006, the back office services were substantially complete, and therefore, the Proffitt's TSA no longer qualified as continuing involvement in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long−Lived Assets." Accordingly, the results of the Proffitt's operations are reflected as discontinued operations in the accompanying consolidated statements of income and the consolidated statements of cash flows for all periods presented.

Additionally, on March 6, 2006, the Company sold to Bon−Ton all outstanding equity interests of certain of the Company's subsidiaries that owned NDSG (operating under the nameplates of Bergner's, Boston Store, Carson Pirie Scott, Herberger's and Younkers), either directly or indirectly. The consideration received consisted of approximately $1,115,000 in cash (reduced as described below based on changes in working capital), plus the assumption by Bon−Ton of approximately $35,000 of unfunded benefits liabilities and approximately $35,000 of capital leases. A working capital adjustment based on working capital as of the effective time of the transaction reduced the amount of cash proceeds by approximately $75,000 resulting in net cash proceeds to the Company of approximately $1,040,000. The disposition included NDSG's operations consisting of, among other things, the following: the real and personal property, operating leases and inventory associated with 142 NDSG units (31 Carson Pirie Scott stores, 14 Bergner's stores, 10 Boston Store stores, 40 Herberger's stores, and 47 Younkers stores), the administrative/headquarters facilities in Milwaukee, Wisconsin, and distribution centers located in Rockford, Illinois, Naperville, Illinois, Green Bay, Wisconsin, and Ankeny, Iowa. NDSG stores generated fiscal 2005 revenues of approximately $2,168,000. The Company realized a net gain of $204,729 on the sale.

Bon−Ton entered into a Transition Service Agreement with the Company ("NDSG TSA"), whereby the Company continued to provide, for varying transition periods, back office services related to the NDSG

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

operations. The back−office services included certain information technology, telecommunications, credit, accounting and store planning services, among others. Bon−Ton compensates the Company for these services, as outlined in the NDSG TSA. The assets and liabilities associated with NDSG were classified as held for sale at January 28, 2006 in the accompanying Consolidated Balance Sheets. Beginning with the third quarter of 2006, the NDSG TSA no longer qualified as continuing involvement in accordance with SFAS No. 144. Accordingly, the results of the NDSG operations are reflected as discontinued operations in the accompanying consolidated statements of income and the consolidated statements of cash flows for all periods presented.

On October 2, 2006, the Company sold to Belk of all of the outstanding equity interests of the Company's subsidiaries that conducted the Parisian business. The consideration received consisted of approximately $285,000 in cash (increased in accordance with a working capital adjustment). A working capital adjustment based on working capital as of the effective time of the transaction increased the amount of cash proceeds by approximately $14,200. In addition, Belk reimbursed the Company at closing for approximately $6,700 in capital expenditures incurred in connection with the construction of four new Parisian stores. Belk also paid the Company a premium associated with the purchase of accounts and accounts receivable from Household Bank (SB), N.A. (now known as HSBC Bank Nevada, N.A., "HSBC"), in the amount of approximately $2,300. The foregoing resulted in total net cash proceeds to the Company of approximately $308,200.

The disposition included Parisian's operations consisting of, among other things, the following: real and personal property, operating leases and inventory associated with 38 Parisian stores (which generated fiscal 2005 revenues of approximately $740,000), a 125,000 square foot administrative/headquarters facility in Birmingham, Alabama and a 180,000 square foot distribution center located in Steele, Alabama. The Company realized a net loss of $12,811 on the sale.

In connection with the consummation of the Parisian transaction, the Company entered into a Transition Services Agreement with Belk dated September 30, 2006 ("Parisian TSA"). Pursuant to the Parisian TSA, the Company will continue to provide, for varying transition periods, back−office services related to the Company's former Parisian specialty department store business. The back−office services include information technology, telecommunications, credit, accounting and store planning services, among others. In accordance with SFAS No. 144, the results of the Parisian operations are reflected as discontinued operations in the accompanying consolidated statements of income and the consolidated statements of cash flows for all periods presented.

Net sales of the aforementioned businesses that are included within discontinued operations in the accompanying Consolidated Statements of Income are $624,290, $3,175,019 and $3,670,300 for 2006, 2005 and 2004, respectively.

**NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated.

The Company's fiscal year ends on the Saturday closest to January 31. Fiscal year 2006 contained 53 weeks and ended on February 3, 2007, and fiscal years 2005 and 2004 each contained 52 weeks and ended on January 28, 2006 and January 29, 2005, respectively.

**NET SALES**

Net sales include sales of merchandise (net of returns and exclusive of sales taxes) and commissions from leased departments related to merchandise sold. Net sales are recognized at the time customers provide a satisfactory form of payment and take ownership of the merchandise or direct its shipment. Revenue associated with gift certificates is recognized upon redemption of the certificate.

The Company estimates the amount of goods that will be returned for a refund and reduces sales and gross margin by that amount. However, given that approximately 22% of merchandise sold is later returned and that the vast majority of merchandise returns are affected within a matter of days of the selling transaction, the risk of the Company realizing a materially different amount for sales and gross margin than reported in the consolidated financial statements is minimal.

Commissions from leased departments included in net sales were $26,558, $26,236 and $27,923 in 2006, 2005 and 2004, respectively. Leased department sales were $180,639, $179,419 and $186,365 in 2006, 2005 and 2004, respectively, and were excluded from net sales.

**CASH AND CASH EQUIVALENTS**

Cash and cash equivalents primarily consist of cash on hand in the stores, deposits with banks and investments with banks and financial institutions that have original maturities of three months or less. Cash equivalents are stated at cost, which approximates fair value. Cash equivalents included $265,508 and $46,665 at February 3, 2007 and January 28, 2006, respectively, invested principally in money market funds. Interest income earned on these cash equivalents was $27,963, $6,829 and $3,680 for the fiscal years ended February 3, 2007, January 28, 2006 and January 29, 2005, respectively, and was reflected in Other Income. There were no balances of restricted cash at February 3, 2007 or January 28, 2006, respectively. At January 28, 2006, Current Assets — Held for Sale included $3,088 of NDSG store cash held for sale.

On March 6, 2006, the Company's Board of Directors declared a cash dividend of $4.00 per common share to shareholders of record as of April 14, 2006, and the Company reduced shareholders' equity for the $ 547,537 dividend. On October 3, 2006 the Company's Board of Directors declared another cash dividend of $4.00 per common share to shareholders of record as of November 15, 2006, and the Company reduced shareholders' equity for the $ 558,587 dividend. For the year ended February 3, 2007, the Company made dividend cash payments totaling $1,095,025, primarily relating to the aggregate $8.00 per common share dividends. The remaining portion of the dividends will be paid prospectively as, and to the extent, awards of restricted stock and performance shares vest.

**MERCHANDISE INVENTORIES AND COST OF SALES (excluding depreciation and amortization)**

Merchandise inventories are valued by the retail method and are stated at the lower of cost (last−in, first−out "LIFO") or market and include freight, buying and distribution costs. The Company takes markdowns related to slow moving inventory, ensuring the appropriate inventory valuation. At February 3, 2007 and January 28, 2006, the LIFO value of inventories exceeded market value and, as a result, inventory was stated at the lower market amount.

Consignment merchandise on hand of $139,431 and $114,436 at February 3, 2007 and January 28, 2006, respectively, is not reflected in the consolidated balance sheets.

The Company receives vendor provided support in different forms. When the vendor provides support for inventory markdowns, the Company records the support as a reduction to cost of sales. Such support is recorded in the period that the corresponding markdowns are taken. When the Company receives inventory−related support that is not designated for markdowns, the Company includes this support as a reduction in the cost of purchases.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES**

Selling, general and administrative expenses (“SG&A”) are comprised principally of the costs related to employee compensation and benefits in the selling and administrative support areas; advertising; store and headquarters occupancy, operating and maintenance costs exclusive of rent, depreciation, and property taxes; proprietary credit card promotion, issuance and servicing costs; insurance programs; telecommunications; and other operating expenses not specifically categorized elsewhere in the consolidated statements of income. Advertising and sales promotion costs are generally expensed in the period in which the advertising event takes place. The Company receives allowances and expense reimbursements from merchandise vendors and from the owner of the proprietary credit card portfolio which are netted against the related expense:

- Allowances received from merchandise vendors in conjunction with incentive compensation programs for employees who sell the vendors’ merchandise and netted against the related compensation expense were $55,007, $50,049 and $51,334 in 2006, 2005 and 2004, respectively.

- Allowances received from merchandise vendors in conjunction with jointly produced and distributed print and television media and netted against the gross expenditures for such advertising were $42,584, $37,956 and $37,896 in 2006, 2005 and 2004, respectively. Net advertising expenses were $37,063, $41,979 and $32,749 in 2006, 2005 and 2004, respectively.

- Expense reimbursements received from the owner of the Company’s proprietary credit card portfolio are discussed at Note 3 to these financial statements.

**STORE PRE−OPENING COSTS**

Store pre−opening costs primarily consist of rent expense incurred during the construction of new stores and payroll and related media costs incurred in connection with new store openings and are expensed when incurred. Rent expense is generally incurred for six to twelve months prior to a store’s opening date.

**PROPERTY AND EQUIPMENT**

Property and equipment are stated at historical cost less accumulated depreciation. For financial reporting purposes, depreciation is computed principally using the straight−line method over the estimated useful lives of the assets. Buildings and improvements are depreciated over 20 to 40 years while fixtures and equipment are primarily depreciated over 3 to 15 years. Leasehold improvements are amortized over the shorter of their estimated useful lives or their related lease terms, generally ranging from 10 to 20 years. Terms of leases used in the determination of estimated useful lives may include renewal periods at the Company's option if exercise of the option is determined to be reasonably assured at the inception of the lease. Costs incurred for the development of internal computer software are capitalized and amortized using the straight−line method over 3 to 10 years. Costs incurred in the discovery and post−implementation stages of internally created computer software are generally expensed as incurred.

When constructing stores, the Company receives allowances from landlords. If the landlord is determined to be the primary beneficiary of the property, then the portion of those allowances attributable to the property owned by the landlord is considered to be a deferred rent liability, whereas the corresponding capital expenditures related to that store are considered to be prepaid rent. Allowances in excess of the amounts attributable to the property owned by the landlord are considered leasehold improvement allowances and are recorded as deferred rent liabilities that are amortized over the life of the lease. Capital expenditures are reduced when the Company receives cash and allowances from merchandise vendors to fund the construction of vendor shops.

At each balance sheet date and as changes in circumstances arise, the Company evaluates the recoverability of its property and equipment based upon the utilization of the assets and expected future cash flows, in accordance with SFAS No. 144. Write−downs associated with the evaluation and any gains or losses on the sale of assets recorded at the time of disposition are reflected in Impairments and Dispositions.

**OPERATING LEASES**

The Company leases stores, distribution centers, and administrative facilities under operating leases. Store lease agreements generally include rent holidays, rent escalation clauses and contingent rent provisions for percentage of sales in excess of specified levels. Most of the Company's lease agreements include renewal periods at the Company's option. The Company recognizes rent holiday periods and scheduled rent increases on a straight−line basis over the lease term beginning with the date the Company takes possession of the leased space and includes such rent expense in Store Pre−Opening Costs. The Company records tenant improvement allowances and rent holidays as deferred rent liabilities on the consolidated balance sheets and amortizes the deferred rent over the terms of the lease to rent expense in the consolidated statements of income. The Company records rent liabilities on the consolidated balance sheets for contingent percentage of sales lease provisions when the Company determines that it is probable that the specified levels will be reached during the fiscal year.

**GOODWILL AND INTANGIBLES**

The Company has allocated the purchase price of previous purchase transactions to identifiable tangible assets and liabilities based on estimates of their fair values and identifiable intangible assets, with the remainder allocated to goodwill. SFAS No. 142, "Goodwill and Other Intangible Assets," requires the discontinuation of goodwill amortization and the periodic testing (at least annually) for the impairment of goodwill and intangible assets. At each year−end balance sheet date and as changes in circumstances arise, the Company performs an evaluation of the recoverability of its goodwill by comparing the estimated fair value to the carrying amount of its assets and goodwill. At February 3, 2007, there was no goodwill reflected in the consolidated balance sheet as the Company disposed of all remaining goodwill in conjunction with the sale of NDSG. At January 28, 2006 the Company had $176,992 of goodwill related entirely to NDSG.

Amortization of the remaining amortizable intangible asset is provided on the straight−line basis over the estimated useful lives of the asset.

**SELF−INSURANCE RESERVES**

The Company self−insures a substantial portion of the exposure for costs related primarily to employee medical, workers' compensation and general liability. Expenses are recorded based on estimates for reported and incurred but not reported claims considering a number of factors, including historical claims experience, severity factors, litigation costs, inflation and other assumptions. Although the Company does not expect the amount it will ultimately pay to differ significantly from estimates, self−insurance reserves could be affected if future claims experience differs significantly from the historical trends and assumptions.

**DERIVATIVES**

The Company uses financial derivatives only to manage its costs and risks in conjunction with specific business transactions. All derivative instruments are recognized on the balance sheet at fair value. The Company cancelled all of its interest rate swap agreements during 2004 resulting in $3,100 of net losses. When combined with net gains from other previously cancelled interest rate swap agreements, the Company had total unamortized net losses of $350 and $584 at February 3, 2007 and January 28, 2006, respectively, that are being amortized as a component of interest expense through 2010.

The Company issued $230,000 of convertible senior unsecured notes during 2004 that bear interest of 2.0% and mature in 2024. The Company used approximately $25,000 of the proceeds from the issuance of the notes to enter into a convertible note hedge and written call options on its common stock to reduce the exposure to dilution from the conversion of the notes.

**STOCK−BASED COMPENSATION PLANS**

The Company maintains an equity stock plan for the granting of options, stock appreciation rights, performance shares, restricted stock, and other forms of equity awards to employees and directors. Options granted generally vest over a four−year period after grant and have an exercise term of seven to ten years from the grant date. Restricted stock and performance shares generally vest one to ten years after the grant date and in some cases with accelerated vesting at the discretion of the Company's Board of Directors.

The Company recorded compensation expense for all stock−based compensation plan issuances prior to 2003 using the intrinsic value method. Compensation expense, if any, was measured as the excess of the market price of the stock over the exercise price of the award on the measurement date. In 2003, the Company began expensing the fair value of all stock−based option grants over the vesting period on a prospective basis utilizing the Black−Scholes model.

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No.123 (revised 2004), "Share−Based Payments." This statement, referred to as "SFAS No. 123R," revised SFAS No. 123, and requires companies to expense the value of employee stock options and similar awards. Effective the beginning of the first quarter 2006, the Company adopted SFAS No.123R. The adoption of this standard had an immaterial

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

effect on the Company's 2006 consolidated financial statements. Total stock−based compensation expense, net of related tax effects, for the years ended February 3, 2007, January 28, 2006 and January 29, 2005 were approximately $31,764, $10,822 and $8,547, respectively.

The Company adopted the alternative transition method, as permitted by FASB Staff Position No. FAS 123R−3, "Transition Election Related to Accounting for the Tax Effects of Share−Based Payment Awards," to calculate the tax effects of stock−based compensation pursuant to SFAS No. 123R for these awards that were outstanding upon adoption of SFAS No. 123R. The alternative transition method allows the use of simplified methods to calculate the beginning capital−in−excess−of−par pool and the consolidated statements of cash flows. Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits resulting from the exercise of stock options as operating cash inflows in the consolidated statements of cash flows, in accordance with the provisions of Emerging Issues Task Force ("EITF") No 00−15, "Classification in the Statements of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option." SFAS No. 123R requires the benefits of tax deductions in excess of the compensation cost recognized for those options to be classified as financing cash inflows rather than operating cash inflows, on a prospective basis. This amount is shown as "Excess tax benefit from stock based compensation."

Had compensation cost for the Company's stock−based compensation plan issuances prior to 2003 been determined under the fair value method, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below.

| | 2005 | 2004 |
|---|---|---|
| Net income as reported herein | $ 22,348 | $ 61,085 |
| Add: Stock−based employee compensation expense included in net income, net of related tax effects | 11,108 | 8,289 |
| Deduct: Total stock−based employee compensation expense determined under the fair value method | (12,413) | (20,444) |
| Pro forma net income | $ 21,043 | $ 48,930 |
| Basic earnings per common share: | | |
| As reported | $ 0.16 | $ 0.44 |
| Pro forma | $ 0.15 | $ 0.35 |
| Diluted earnings per common share: | | |
| As reported | $ 0.16 | $ 0.44 |
| Pro forma | $ 0.15 | $ 0.35 |

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

**EARNINGS PER SHARE**

Basic earnings per share ("EPS") have been computed based on the weighted average number of common shares outstanding.

| | 2006 | | | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Net Income | Shares | Per Share Amount | Net Income | Shares | Per Share Amount | Net Income | Shares | Per Share Amount |
| Basic EPS | $53,742 | 135,880 | $ 0.40 | $22,348 | 138,348 | $ 0.16 | $61,085 | 139,470 | $ 0.44 |
| Effect of dilutive stock options | — | — | — | — | — | — | — | — | — |
| Diluted EPS | $53,742 | 135,880 | $ 0.40 | $22,348 | 138,348 | $ 0.16 | $61,085 | 139,470 | $ 0.44 |

The Company had 6,546, 10,840 and 20,634 option awards of potentially dilutive common stock outstanding at February 3, 2007, January 28, 2006 and January 29, 2005, respectively, that were not included in the computation of diluted EPS because the Company had a loss from continuing operations for the period or the exercise prices of the options were greater than the average market price of the common shares for the period. There were also 19,219, 15,413 and 12,307 of potentially exercisable shares under convertible notes at February 3, 2007, January 28, 2006 and January 29, 2005, respectively, that were not included in the computation of diluted EPS due to the assumption of net share settlement as discussed below.

The EITF reached a consensus, EITF 04−08, "The Effect of Contingently Convertible Instruments on Diluted Earnings Per Share," whereby the contingent conversion provisions should be ignored and therefore an issuer should apply the if−converted method in calculating dilutive earnings per share. This consensus became effective for periods ending after December 15, 2004, and requires retroactive application to all periods presented. Although the Company is now required to ignore the contingent conversion provision on its convertible notes under EITF 04−08, it can still presume that it will satisfy the net share settlement upon conversion of the notes in cash, and thus exclude the effect of the conversion of the notes in its calculation of dilutive earnings per share. However, the FASB is contemplating an amendment to SFAS No. 128, "Earnings Per Share," that would require the Company to ignore the cash presumption of net share settlement and to assume share settlement for purposes of calculating diluted earnings per share.

**PENSION PLANS**

Pension expense is based on information provided by outside actuarial firms that use assumptions provided by the Company to estimate the total benefits ultimately payable to associates and is allocated to the service periods. The actuarial assumptions used to calculate pension costs are reviewed annually. The Company's funding policy provides that contributions to the pension trusts shall be at least equal to the minimum funding requirement of the Employee Retirement Income Security Act of 1974. The Company may also provide additional contributions from time to time, generally not to exceed the maximum tax−deductible limitation.

The pension plans are valued annually on November 1st. The projected unit credit method is utilized in recognizing the pension liabilities.

**GIFT CARDS**

The Company sells gift cards with no expiration dates. At the time gift cards are sold, no revenue is recognized; rather a liability is established for the value of the card. The liability is relieved and revenue is recognized when the gift cards are redeemed by the customer for merchandise. The liability for unredeemed gift cards aggregated $37,300 and $51,900 at February 3, 2007 and January 28, 2006, respectively.

Outstanding gift cards may be subject to state escheatment laws. The Company periodically evaluates unredeemed gift cards and if a determination is made that it is remote that the gift card will be redeemed and if it is determined that the gift card is not subject to escheatment, then the Company will reverse the unredeemed liability. There were no reversal amounts reflected in cost of sales in 2006, 2005 and 2004.

**INCOME TAXES**

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

**NEW ACCOUNTING PRONOUNCEMENTS**

In July 2006, the FASB issued Interpretation 48 ("FIN 48") Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109, Accounting for Income Taxes. This interpretation clarifies the application of Statement 109 by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements. For a benefit to be recognized, a tax position must be more−likely−than−not to be sustained upon examination by taxing authorities. The benefit to be recognized for a tax position that meets the more−likely−than−not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. FIN 48 also provides guidance on derecognition, classification of interest and penalties, accounting in interim periods, and disclosure. The Company will adopt FIN 48 as of February 4, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded as an adjustment to shareholders' equity in the first quarter of 2007. The adoption of FIN 48 is not expected to have a material impact on the Company's consolidated financial statements. The Company expects to record an adjustment to increase shareholders' equity by $30,000 to $40,000.

The FASB is contemplating an amendment to SFAS No. 128, "Earnings Per Share," that would require the Company to ignore the cash presumption of net share settlement and to assume share settlement for purposes of calculating diluted earnings per share. Although the Company is now required to ignore the contingent conversion provision on its convertible notes under EITF 04−08, it can still presume that it will satisfy the net share settlement upon conversion of the notes in cash, and thus exclude the effect of the conversion of the notes in its calculation of dilutive earnings per share. If and when the FASB amends SFAS No. 128, the effect of the changes would require the Company to use the if−converted method in calculating dilutive earnings per share except when the effect would be anti−dilutive. The effect of adopting the amendment to SFAS No. 128 would increase the number of shares in the Company's dilutive calculation by 19,219 shares.

During September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or a liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under SFAS No. 157, fair value measurements would be separately disclosed by level within the fair value hierarchy effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this Statement and does not expect it to have a material impact on the Company's results of operations or financial position.

On September 29, 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS No. 158"). The Company adopted SFAS No. 158 prospectively on February 3, 2007. SFAS No. 158 requires an employer that sponsors one or more defined benefit pension plans or other postretirement plans to 1) recognize the funded status of a plan, measured as the difference between plan assets at fair value and the benefit obligation, in the balance sheet; 2) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost; 3) measure defined benefit plan assets and obligations as of the date of the employer's fiscal year−end balance sheet; and 4) disclose in the notes to the financial statements additional information about the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations. The adoption of SFAS No. 158 did not have a material effect on the Company's results of operations or financial position for the fiscal year ended February 3, 2007. Additionally, SFAS No. 158 will require the Company to change the measurement date for the assets and liabilities of its employee benefit plans from November 1 to the Company's fiscal year end beginning with the year ending January 31, 2009.

**NOTE 3 — PROPRIETARY CREDIT CARD RECEIVABLES**

On April 15, 2003, the Company sold its proprietary credit card portfolio, consisting of the proprietary credit card accounts owned by NBGL and the Company's ownership interest in the assets of the trust to HSBC, a third party financial institution.

HSBC, an affiliate of HSBC Holdings PLC, offers proprietary credit card accounts to the Company's customers. Pursuant to a program agreement with a term of ten years expiring in 2013, HSBC establishes and owns proprietary credit card accounts for the Company's customers, retains the benefits and risks associated with the ownership of the accounts, receives the finance charge income and incurs the bad debts associated with those accounts. During the ten−year term, pursuant to a servicing agreement, the Company continues to provide key customer service functions, including new account opening, transaction authorization, billing adjustments and customer inquiries, and receives compensation from HSBC for these services.

At the end of the ten−year term expiring in 2013, the agreement can be renewed for two two−year terms. At the end of the agreement, the Company has the right to repurchase, at fair value, all of the accounts and outstanding accounts receivable, negotiate a new agreement with HSBC or begin issuing private label credit cards itself or through others. The agreement allows the Company to terminate the agreement early following the occurence of certain events, the most significant of which would be HSBC's failure to pay owed amounts, bankruptcy, a change in control or a material adverse change in HSBC's ability to perform under the agreement. The agreement also allows for HSBC to terminate the agreement if the Company fails to pay owed amounts or enters bankruptcy. Should either the Company or HSBC choose to terminate the agreement early, the Company has the right, but not the requirement, to repurchase the credit card accounts and associated accounts receivable from HSBC at their fair value. The Company is contingently liable to pay monies to HSBC in the event of an early termination or a significant disposition of stores. The contingent payment is based upon a declining portion of an amount established at the beginning of the ten−year agreement and on a prorated portion of significant store closings. The maximum contingent payment had the agreement been terminated early at February 3, 2007 would have been approximately $33,000. Management believes the risk of incurring a contingent payment is remote.

(Dollar amounts in thousands, except per share amounts)

In September of 2006 the Company entered into agreements with HSBC and MasterCard to issue a co−branded MasterCard to new and existing proprietary credit card customers. Under this program, qualifying customers are issued a SFA and MasterCard branded credit card that functions as a traditional proprietary credit card when used at any SFA or Off 5th store and at Saks Direct or as a MasterCard when used at any unaffiliated location that accepts MasterCard. HSBC establishes and owns the co−brand accounts, retains the benefits and sales associated with the ownership of the accounts, receives the finance charge and other income from the accounts, and incurs the bad−debts associated with the accounts.

With the exception of depreciation expense, all components of the credit card operations are included in SG&A. The credit contribution was represented by program compensation and servicing compensation. For 2006, 2005 and 2004, the components of the credit contribution included in SG&A were $58,038, $61,047 and $59,298, respectively.

## NOTE 4 — PROPERTY AND EQUIPMENT

A summary of property and equipment is as follows:

| | February 3, 2007 | January 28, 2006 |
|---|---|---|
| Land and land improvements | $ 187,102 | $ 236,261 |
| Buildings | 570,045 | 877,744 |
| Leasehold improvements | 333,296 | 566,779 |
| Fixtures and equipment | 736,475 | 1,358,158 |
| Construction in progress | 75,974 | 82,232 |
| | 1,902,892 | 3,121,174 |
| Accumulated depreciation | (803,561) | (1,343,894) |
| | $1,099,331 | $ 1,777,280 |

Depreciation expense was $128,495, $133,529, and $129,258 in 2006, 2005 and 2004, respectively. In 2006, 2005 and 2004, the Company realized net charges (gains) of $7,855, $(10,999) and $20,628, respectively, related to property and equipment that were included in impairment and disposition charges. The 2006 net charges primarily related to lease termination costs related to store closings and asset impairments. The 2005 net gains primarily related to the insurance settlement on the SFA store in New Orleans which suffered substantial water, fire and other damage related to Hurricane Katrina, partially offset by asset impairments associated with store closings or impairments in the normal course of business. The 2004 net charges primarily related to the asset impairments associated with the announced SFA store closings and other store closings or impairments in the normal course of business, partially offset by gains realized on the sale of stores. Based upon its most recent analysis at February 3, 2007, the Company believes that no additional impairment of property and equipment currently exists.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

### NOTE 5 — GOODWILL AND OTHER INTANGIBLE ASSETS

At February 3, 2007, there was no goodwill reflected in the consolidated balance sheet; however, at January 28, 2006 the Company had $176,992 of goodwill recorded in the consolidated balance sheet. During 2006, the Company disposed of $176,992 of goodwill in conjunction with the sale of NDSG.

The changes in the carrying amounts of goodwill for 2006 and the components of other amortizable assets at February 3, 2007 were as follows:

| | |
|---|---|
| Goodwill balance at January 28, 2006 | $ 176,992 |
| Sale of NDSG | (176,992) |
| Goodwill balance at February 3, 2007 | — |
| Other amortizable intangible assets: | |
| Customer lists | 22,710 |
| Tradenames | 2,308 |
| Accumulated amortization | (18,604) |
| | 6,414 |
| Sale of NDSG | (1,789) |
| Sale of Parisian | (4,301) |
| Other amortizable intangible assets, net | 324 |
| Total Intangibles at February 3, 2007 | $ 324 |

Amortization expense was approximately $27 in 2006, 2005 and 2004, and will remain consistent for each of the next 5 years.

### NOTE 6 — INCOME TAXES

The components of income tax expense were as follows:

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Current: | | | |
| Federal | $(102,216) | $(165,526) | $(67,288) |
| State | (26,554) | (27,552) | (15,625) |
| | (128,770) | (193,078) | (82,913) |
| Deferred: | | | |
| Federal | 86,197 | 88,571 | 27,878 |
| State | 7,790 | 11,346 | (15,989) |
| | 93,987 | 99,917 | 11,889 |
| Total expense | $ (34,783) | $ (93,161) | $(71,024) |

(Dollar amounts in thousands, except per share amounts)

Components of the net deferred tax asset or liability recognized in the consolidated balance sheets were as follows:

| | February 3, 2007 | January 28, 2006 |
|---|---|---|
| Current: | | |
| Deferred tax assets: | | |
| Accrued expenses | $ 30,951 | $ 48,741 |
| NOL carryforwards | 22,250 | 102,359 |
| Valuation allowance | (8,104) | (9,013) |
| Deferred tax liabilities: | | |
| Inventory | (4,334) | (22,529) |
| Net current deferred tax asset | $ 40,763 | $ 119,558 |
| Non−current: | | |
| Deferred tax assets: | | |
| Capital leases | $ 13,937 | $ 39,083 |
| Other long−term liabilities | 76,869 | 125,408 |
| AMT Credit | 24,756 | 21,213 |
| NOL carryforwards | 85,114 | 85,718 |
| Valuation allowance | (39,488) | (38,091) |
| Deferred tax liabilities: | | |
| Property and equipment | (8,457) | (35,728) |
| Other assets | 23 | (6,123) |
| Net non−current deferred tax asset | $ 152,754 | $ 191,480 |

At February 3, 2007, the Company had $85,072 of federal net operating loss carryforwards (“NOLs”). This amount considers the fact that the carryforwards are restricted under federal income tax change−in−ownership rules. The federal and state NOL carryforwards will expire between 2007 and 2026. The Company believes it will be sufficiently profitable during the periods from 2007 to 2026 to utilize all of its federal NOLs and a significant portion of its existing state NOLs and a valuation allowance has been established against that portion that the Company currently does not anticipate being able to utilize based on current projections.

As noted above, a valuation allowance has been established against a portion of the Company’s existing NOLs. During 2006, the valuation allowance was evaluated on a jurisdiction−by−jurisdiction basis which resulted in a net reduction to the overall valuation allowance of $1,465 based on projections of future profitability. A similar analysis was performed in 2005, which resulted in a net reduction to the overall valuation allowance of $1,364. Of this amount, $1,161 was recorded as income tax expense and $2,525 was credited to Shareholders’ Equity in accordance with Statement of Position 90−7 (SOP 90−7) Financial Reporting by Entities in Reorganization Under the Bankruptcy Code, which states that benefits realized from deferred taxes should be reported as an addition to paid−in capital. Despite an overall reduction to the valuation allowance in both 2005 and 2006, the valuation allowance was increased in certain jurisdictions due to the fact that the Company’s presence in these jurisdictions decreased after the sale of the NDSG and Parisian businesses.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

Income tax expense varies from the amount computed by applying the statutory federal income tax rate to income before taxes. The reasons for this difference were as follows:

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Expected federal income taxes at 35% | $(14,744) | $(79,382) | $(52,930) |
| State income taxes, net of federal benefit | (10,733) | (11,963) | (9,362) |
| State NOL valuation allowance adjustment | (1,465) | 1,161 | (10,138) |
| Effect of settling tax exams and other tax reserve adjustments | (10,150) | — | 2,555 |
| Executive Compensation | 2,439 | — | — |
| Tax−Exempt Interest | (1,761) | — | — |
| Other items, net | 1,631 | (2,977) | (1,149) |
| Provision for income taxes | $(34,783) | $(93,161) | $(71,024) |

During 2006, the Company favorably concluded certain tax examinations which resulted in an income tax benefit of $10,150. The Company analyzed its positions related to the reserve for tax exposures and determined the amount was adequate. The Company will continue to analyze its positions related to the reserve for tax exposures on an ongoing basis.

During 2004, the statute of limitations expired with respect to certain tax examination periods. This resulted in a reduction of $4,586 to the Company’s reserve for tax exposures which was credited to Shareholder’s Equity in accordance with SOP 90−7. The Company also re−assessed its uncertain federal and state tax filing positions resulting in an increase to its reserve for tax exposures of $2,555. In addition, the valuation allowance was reduced by $20,638 based on projections of future profitability, which included the gain related to the sale of Proffitt’s in 2005. Of this amount, $10,138 was recorded as an income tax benefit and the remaining $10,500 was credited to Shareholders’ Equity in accordance with SOP 90−7.

The Company made income tax payments, net of refunds received of $34,322, $18,278 and, $1,939 during 2006, 2005 and 2004, respectively.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

## NOTE 7 — DEBT

A summary of Long−Term Debt is as follows:

| | February 3, 2007 | January 28, 2006 |
|---|---|---|
| Notes 8.25%, maturing 2008 | $ 190,324 | $ 190,324 |
| Notes 7.50%, maturing 2010 | 45,872 | 45,872 |
| Notes 9.875%, maturing 2011 | 141,557 | 141,557 |
| Notes 7.00%, maturing 2013 | 3,022 | 3,022 |
| Notes 7.375%, maturing 2019 | 1,911 | 2,104 |
| Convertible Notes 2.00%, maturing 2024 | 230,000 | 230,000 |
| Revolving credit agreement | — | — |
| Real estate and mortgage | — | 215 |
| Capital lease obligations | 74,341 | 118,018 |
| | 687,027 | 731,112 |
| Terminated interest rate swap agreements, net | (350) | (584) |
| Current portion | (236,667) | (7,792) |
| | $ 450,010 | $ 722,736 |

### REVOLVING CREDIT AGREEMENT

At the Company's request, due to the sale of NDSG, the revolving credit agreement was reduced from $800,000 to $500,000 in March 2006. In September 2006, the maturity date of the revolving credit agreement was extended to September 2011. The facility is secured by the Company's merchandise inventories and certain third party accounts receivable, and borrowings are limited to a prescribed percentage of eligible inventories and receivables. At February 3, 2007 the carrying amount of inventories securing the credit agreement was $673,973 and the $500,000 credit limit exceeded the prescribed percentage of eligible inventories by $23,235. The carrying amount of the third party accounts receivable was $14,881 at February 3, 2007.

During periods in which availability under the agreement exceeds $60,000, the Company is not subject to financial covenants. If and when availability under the agreement decreases to less than $60,000, the Company will be subject to a minimum fixed charge coverage ratio of 1 to 1. There is no debt rating trigger. The revolving credit agreement restricts additional debt to specific categories including the following (each category being subject to limitations as described in the revolving credit agreement): debt arising from permitted sale and leaseback transactions; debt to finance purchases of machinery, equipment, real estate and other fixed assets; debt in connection with permitted acquisitions; and unsecured debt. The Company routinely issues stand−by and documentary letters of credit for purposes of securing foreign sourced merchandise, certain equipment leases, certain insurance programs and other contingent liabilities. Outstanding letters of credit reduce availability under the revolving line of credit. The facility contains default provisions that are typical for this type of financing, including a provision that would trigger a default of the facility if a default were to occur in another debt instrument resulting in the acceleration of principal of more than $20,000 in that other instrument. During 2006, weighted average letters of credit issued under the credit agreement were $96,763. The highest amount of letters of credit outstanding under the agreement during 2006 was $137,115, principally related to the funding of seasonal working capital needs. At February 3, 2007 the Company had no principal borrowings and had letters of credit outstanding of $48,252. Borrowings bear interest at either LIBOR plus a percentage ranging from 1.00% to 1.50% or at the higher of the prime rate and federal funds rate plus 0.50%. Letters of credit are charged a fee on an annual basis equal to the then applicable borrowing spread.

**SENIOR NOTES**

At February 3, 2007, the Company had $382,686 of unsecured senior notes outstanding, excluding the convertible notes, comprised of five separate series having maturities ranging from 2008 to 2019 and interest rates ranging from 7.00% to 9.88%. The senior notes have substantially identical terms except for the maturity dates and interest rates payable to investors. The notes restrict incurring secured debt to no more than 15% of consolidated tangible net assets of the Company less sale/leaseback transactions, plus debt secured by liens on specified categories of property and equipment. The terms of each senior note require all principal to be repaid at maturity. There are no financial covenants associated with these notes, and there are no debt−rating triggers.

On March 14, 2007, the Company announced that it had commenced a modified “Dutch Auction” tender offer to purchase a portion of its 8 $^{1}/4$% senior notes due November 15, 2008 for an aggregate purchase price not to exceed $100,000 (the “offer cap”). Under the modified “Dutch Auction” procedure, the Company agreed to accept the senior notes validly tendered in the order of highest to lowest spreads specified by the holders and agreed to select the single highest spread that would enable the Company to purchase an amount of the senior notes having an aggregate purchase price up to the offer cap (or, if the senior notes having an aggregate purchase price less than the offer cap are validly tendered, all senior notes so tendered). The offer expires on April 11, 2007, unless extended.

On July 19, 2005, the Company completed cash tender offers and consent solicitations for three issues of its outstanding senior notes and consent solicitations with respect to two additional issues of its senior notes and its convertible notes. The Company repurchased a total of approximately $585,672 in principal amount of senior notes and received consents from holders of a majority of every issue of its senior notes and of its convertible notes. The notes were repurchased at par, which included a consent fee. The repurchase of these notes resulted in a loss on extinguishment of debt of $28,991 related principally to the write−off of deferred financing costs and a premium on previously exchanged notes.

Additionally, the Company repurchased $21,435 of additional senior notes at par through unsolicited open market repurchases during August 2005. The repurchase of these notes resulted in a loss on extinguishment of debt of $384.

**CONVERTIBLE NOTES**

The Company had $230,000 of convertible senior unsecured notes outstanding, at February 3, 2007, that bear interest of 2.0% and mature in 2024. The provisions of the convertible notes allow the holder to convert the notes to shares of the Company’s common stock at a conversion rate of 83.5609 shares per one thousand dollars in principal amount of notes. The most significant terms and conditions related to the convertible notes include: the Company can settle a conversion of the notes with shares and/or cash; the holder may put the notes back to the Company in 2014 or 2019; the holder cannot convert the notes until the Company’s share price exceeds the conversion price by 20% for a certain trading period; the Company can call the notes on or after March 11, 2011; the conversion rate is subject to a dilution adjustment; and the holder can convert the notes upon a significant credit rating decline and upon a call. The Company used approximately $25,000 of the proceeds from the issuance of the notes to enter into a convertible note hedge and written call options on its common stock to reduce the exposure to dilution from the conversion of the notes.

(Dollar amounts in thousands, except per share amounts)

During the year ended February 3, 2007, the aforementioned conversion criterion was met. The closing price of the Company's common stock exceeded 120% of the convertible senior notes' conversion price for at least 20 out of 30 trading days in the fourth calendar quarter of 2006. The Company gave notice on January 3, 2007 that the holders of the convertible notes could convert them into shares of the Company's common stock until March 30, 2007 in accordance with, and subject to, the terms of the convertible notes indenture. As of February 3, 2007, no note holders have converted their notes into the Company's common stock. Since the holders of the convertible notes have the ability to exercise their conversion rights, the convertible notes were classified within the "current portion of long−term debt" on the Company's February 3, 2007 balance sheet.

**MATURITIES**

At February 3, 2007, maturities of long−term debt for the next five years and thereafter are as follows:

| Year | Maturities |
|---|---|
| 2007 | $ 236,667 |
| 2008 | 195,501 |
| 2009 | 5,230 |
| 2010 | 51,462 |
| 2011 | 146,580 |
| Thereafter | 51,237 |
| | $ 686,677 |

The Company made interest payments of $50,409, $89,995 and $100,294, of which $3,807, $3,980 and $3,461 was capitalized into property and equipment during 2006, 2005 and 2004, respectively.

**NOTE 8 — COMMITMENTS AND CONTINGENCIES**

**OPERATING LEASES AND OTHER PURCHASE COMMITMENTS**

The Company leases certain property and equipment under various non−cancelable capital and operating leases. The leases provide for monthly fixed amount rentals or contingent rentals based upon sales in excess of stated amounts and normally require the Company to pay real estate taxes, insurance, common area maintenance costs and other occupancy costs. Generally, the leases have primary terms ranging from 20 to 30 years and include renewal options ranging from 5 to 20 years.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

At February 3, 2007, future minimum rental commitments under capital leases and non−cancelable operating leases consisted of the following:

| | Operating Leases | Capital Leases |
|---|---|---|
| 2007 | $ 66,153 | $ 17,186 |
| 2008 | 64,529 | 15,726 |
| 2009 | 57,906 | 15,295 |
| 2010 | 53,071 | 14,499 |
| 2011 | 51,712 | 13,890 |
| Thereafter | 230,490 | 127,221 |
| | $523,861 | 203,817 |
| Amounts representing interest | | (129,476) |
| Capital lease obligations | | $ 74,341 |

Total rental expense for operating leases was $114,718, $109,000 and $106,677 during 2006, 2005 and 2004, respectively, including contingent rent of $18,415, $17,854 and $17,909, respectively, and common area maintenance costs of $11,006, $10,584 and $11,298, respectively. The gross amount of assets recorded under capital leases as of February 3, 2007 and January 28, 2006 was $134,825 and $155,070, respectively.

As of February 3, 2007, the Company had two potential commitments tied to the value of its common stock. First, the Company may be required to deliver shares and/or cash to holders of the convertible notes described in Note 7 prior to the stated maturity date of said notes based on the value of the Company's common stock. Second, in connection with the issuance of the convertible notes, the Company bought and sold call options to limit the potential dilution from conversion of the notes. The Company may be required to deliver shares and/or cash to the holders of the call options based on the value of the Company's common stock.

In the normal course of business, the Company purchases merchandise under purchase commitments; enters contractual commitments with real estate developers and construction companies for new store construction and store remodeling; and maintains contracts for various information technology, telecommunications, maintenance and other services. Commitments for purchasing merchandise generally do not extend beyond six months and may be cancelable several weeks prior to the vendor shipping the merchandise. Contractual commitments for the construction and remodeling of stores are typically lump sum or cost plus construction contracts. Contracts to purchase various services are generally less than one to two years and are cancelable within several weeks notice.

**LEGAL CONTINGENCIES**

***Investigations***

At management's request, the Audit Committee of the Company's Board of Directors conducted an internal investigation in 2004 and 2005. In 2004, the Company informed the SEC of the Audit Committee's internal investigation. Thereafter, the Company was informed by the SEC that it issued a formal order of private investigation. Thereafter, the Company was informed that the Office of the United States Attorney for the Southern District of New York had instituted an inquiry. The Company believes that the subject of these inquiries includes one or more of the matters that were the subject of the investigations by the Audit Committee and possibly includes related matters. The results of the Audit Committee's internal investigation have been previously disclosed by the Company. The Company has responded to subpoenas and other requests for information from the SEC, including a subpoena requesting information concerning, among other items, the Company's allocation to vendors of a portion of markdown costs associated with certain of the Company's customer loyalty and other promotional activities, as well as information concerning markdowns, earnings, and other financial data for 1999−2003. The Company is continuing to fully cooperate with the SEC and the Office of the United States Attorney, whose investigations the Company understands are continuing.

***Vendor Litigation***

On May 17, 2005, International Design Concepts, LLC ("IDC") commenced litigation against the Company in the United States District Court for the Southern District of New York raising various claims, including breach of contract, fraud and unjust enrichment. The suit alleges that from 1996 to 2003 the Company improperly took chargebacks and deductions for vendor markdowns, which resulted in IDC going out of business. The suit seeks damages in the amount of the unauthorized chargebacks and deductions. IDC filed a second amended complaint on June 14, 2005 asserting an additional claim for damages under the Uniform Commercial Code for vendor compliance chargebacks.

On October 25, 2005 the Chapter 7 trustee for the bankruptcy estate of Kleinert's Inc. filed a complaint against the Company and several of its subsidiaries in the United States Bankruptcy. Court for the Southern District of New York. In its initial complaint the plaintiff, as assignee, alleged breach of contract, fraud, and unjust enrichment, among other causes of action, and seeks compensatory and punitive damages due to the Company's assessment of alleged improper chargebacks against Kleinert's Inc. totaling approximately $4 million which wrongful acts the plaintiff alleges caused the insolvency and bankruptcy of Kleinert's Inc. On August 15, 2006 the plaintiff, as assignee, filed an amended complaint in which it asserts the following claims, among others: (1) defendants applied improper chargebacks to the accounts payable of Kleinert's, which led to the extreme financial distress and Kleinert's eventual bankruptcy and Kleinert's incurred liabilities and lost profits of at least $100,000 and plaintiff requests punitive damages of no less than $50,000 (conversion claim); (2) from 1998− 2003 defendants charged back an amount not less than $4 million to Kleinert's and these chargebacks improperly benefited the defendants, and plaintiff requests $4 million on this claim (unjust enrichment claim); (3) defendants falsely represented that its $4 million in chargebacks were proper and Kleinert's reliance on defendants' misrepresentations caused Kleinert's to lose not less than $4 million and caused it to file for bankruptcy resulting in liabilities and lost profits of $100,000, and plaintiff requests punitive damages of no less than $50,000 (fraud claim); (4) defendants wrongfully charged back at least $4 million and these unwarranted chargebacks assisted Kleinert's officers and directors in booking fictitious sales revenue and accounts receivable and perpetrating a fraud on Kleinert's lenders in excess of $25,000, and plaintiff requests punitive damages of no less than $50,000 (fraud claim); (5) defendants used dishonest, improper and unfair means in conducting business with Kleinert's and interfered with Kleinert's relationship with its lenders (tortious interference with prospective economic advantage claim); (6) defendants assisted officers of Kleinert's in breaching their fiduciary duties to Kleinert's and to its creditors by falsifying borrowing base certificates given to the lenders, and defendants knew that their improper chargeback scheme was assisting these breaches of fiduciary duty by Kleinert's officers, with respect to which plaintiff requests $100,000 plus $50,000 in punitive damages (aiding and abetting breach of fiduciary duty claim); (7) defendants knew that their improper chargeback scheme was assisting the perpetration of fraud by Kleinert's officers, and plaintiff requests $100,000 plus $50,000 in punitive damages (aiding and abetting fraud claim); and (8) various fraudulent conveyance claims with respect to which plaintiff requests damages of $4,000.

On December 8, 2005 Adamson Apparel, Inc. filed a purported class action lawsuit against the Company in the United States District Court for the Northern District of Alabama. In its complaint the plaintiff asserts breach of contract claims and alleges that the Company improperly assessed chargebacks, timely payment discounts, and deductions for merchandise returns against members of the plaintiff class. The lawsuit seeks compensatory and incidental damages and restitution.

***Shareholders' Derivative Suits***

On April 29, 2005, a shareholder derivative action was filed in the Circuit Court of Jefferson County, Alabama for the putative benefit of the Company against the members of the Board of Directors and certain executive officers alleging breach of their fiduciary duties in failing to correct or prevent problems with the Company's accounting and internal control practices and procedures, among other allegations. Two similar shareholder derivative actions were filed on May 4, 2005 and May 5, 2005, respectively, in the Chancery Court of Davidson County, Tennessee. All three actions generally sought unspecified damages and disgorgement by the executive officers named in the complaints of cash and equity compensation received by them. Two of the lawsuits were dismissed with prejudice in late 2006 and the third lawsuit was dismissed with prejudice in early 2007. In connection with the dismissals no payments were made to the plaintiffs or their counsel by or on behalf of the Company or any of the individual defendants and none of the Company and the individual defendants incurred or agreed to undertake any obligation or liability to the plaintiffs.

***Other***

The Company is involved in several legal proceedings arising from its normal business activities and has accruals for losses where appropriate. Management believes that none of these legal proceedings will have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

**INCOME TAXES**

The Company is routinely under audit by federal, state or local authorities in the areas of income taxes and the remittance of sales and use taxes. These audits include questioning the timing and amount of deductions and the allocation of income among various tax jurisdictions. Based on annual evaluations of tax filing positions, the Company believes it has adequately accrued for exposures. To the extent the Company were to prevail in matters for which accruals have been established or be required to pay amounts in excess of reserves, the Company's effective tax rate in a given financial statement period may be materially impacted. At February 3, 2007 certain state examinations were ongoing.

**NOTE 9 — EMPLOYEE BENEFIT PLANS**

**EMPLOYEE SAVINGS PLANS**

The Company sponsors various qualified savings plans that cover substantially all full−time employees. Company contributions charged to expense under these plans for 2006, 2005 and 2004 were $5,661, $5,381 and $6,569, respectively. At February 3, 2007, total invested assets related to the employee savings plans was $522,258, of which approximately 4% was invested in the Company's stock at the discretion of the participating employees.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

**DEFINED BENEFIT PLANS**

The Company sponsors a defined benefit cash balance pension plan for many employees of the Company. In conjunction with the sale of NDSG, the Company sold to Bon−Ton the assets, and Bon−Ton assumed the liabilities, of the Carson cash balance pension plan. The Company generally funds pension costs, currently subject to regulatory funding requirements. The Company expects minimal funding requirements in 2007 and 2008.

In September 2006, the FASB issued SFAS No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." The Company adopted SFAS No. 158 prospectively on February 3, 2007. This Statement requires the Company to recognize an asset or liability for the overfunded or underfunded status of its pension and other postretirement benefit plans. SFAS No. 158 requires the Company to recognize all unrecognized prior service costs and credits and unrecognized actuarial gains and losses in accumulated other comprehensive income ("AOCI"), net of tax. Such amounts will be adjusted as they are subsequently recognized as components of net periodic benefit cost or income pursuant to the current recognition and amortization provisions.

Additionally, the Company curtailed its pension plan during 2006 which froze benefit accruals for all participants except those who have attained age 55 and completed 10 years of service as of December 31, 2006 and who continue to be non−highly compensated employees.

The components of net periodic pension expense related to the Company's remaining pension plan were as follows:

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Net periodic pension expense: | | | |
| Service cost | $ 4,841 | $ 4,764 | $ 4,401 |
| Interest cost | 8,516 | 8,528 | 9,127 |
| Expected return on plan assets | (9,592) | (9,300) | (9,644) |
| Recognized actuarial loss | 4,202 | 4,153 | 2,999 |
| Net amortization of losses and prior service costs | (395) | (460) | (460) |
| Net pension expense | 7,572 | 7,685 | 6,423 |
| FAS 88 charge | 443 | — | — |
| Total pension expense | $ 8,015 | $ 7,685 | $ 6,423 |
| Gain recognized due to curtailment | $(4,303) | $ — | $ — |

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

| | 2006 | 2005 |
|---|---|---|
| **Change in benefit obligation:** | | |
| Benefit obligation at beginning of period (November 1) | $ 396,986 | $ 396,252 |
| Removal of benefit obligation related to sale of NDSG | (228,570) | — |
| Adjusted benefit obligation at beginning of period (November 1) | 168,416 | 396,252 |
| Service cost | 4,841 | 7,651 |
| Interest cost | 8,516 | 21,376 |
| Actuarial loss | (73) | 4,380 |
| Benefits paid | (17,785) | (32,673) |
| Benefit obligation at end of period (November 1) | $ 163,915 | $ 396,986 |
| **Change in plan assets:** | | |
| Fair value of plan assets at beginning of period (November 1) | $ 325,625 | $ 314,301 |
| Removal of fair value of plan assets related to sale of NDSG | (191,568) | — |
| Adjusted fair value of plan assets at beginning of period (November 1) | 134,057 | 314,301 |
| Actual return on plan assets | 20,847 | 35,722 |
| Employer contributions | 15,169 | 8,275 |
| Benefits paid | (17,785) | (32,673) |
| Administrative expenses | (1,129) | — |
| Fair value of plan assets at end of period (November 1) | $ 151,159 | $ 325,625 |
| **Pension plans' funding status (1):** | | |
| Accumulated benefit obligation at November 1 | $(163,905) | $(390,439) |
| Effect of projected salary increases | (10) | (6,547) |
| Projected benefit obligation at November 1 | (163,915) | (396,986) |
| Fair value of plan assets at November 1 | 151,159 | 325,625 |
| Funded status at November 1 | (12,756) | (71,361) |
| Unrecognized actuarial loss | — | 129,461 |
| Unrecognized prior service cost | — | 129 |
| Contributions subsequent to November 1 | 260 | 404 |
| Prepaid (accrued) pension cost classified in other liabilities at balance sheet date | $ (12,496) | $ 58,633 |
| **Amounts recognized in the consolidated balance sheet:** | | |
| Noncurrent asset | $ 4,553 | $ — |
| Current liabilities | (2,387) | — |
| Noncurrent liabilities | (14,662) | (64,410) |
| Accumulated OCI | — | 5,210 |
| Additional minimum pension liability (reflected in Shareholders' Equity, net of tax) | — | 117,833 |
| Net amount recognized at balance sheet date | $ (12,496) | $ 58,633 |
| **Assumptions:** | | |
| Discount rate, at end of period | 5.50% | 5.65% |
| Expected long−term rate of return on assets, for periods ended February 3, 2007 and January 28, 2006 | 8.00% | 7.50% |
| Average assumed rate of compensation increase | 4.00% | 4.00% |
| Measurement date | 11/1/06 | 11/1/05 |

(1) After adoption of SFAS No. 158 on February 3, 2007, these amounts are recorded and this reconciliation is no longer required.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

In 2007, estimated AOCI amortization of prior service credit and amortization of net loss is $70 and $3,338, respectively, for the pension plan. No refunds are expected from the benefit plan during 2007.

Amounts not yet reflected in net periodic benefit costs and included in AOCI as of February 3, 2007 are as follows:

| | 2006 |
|---|---|
| Prior service credit | $ (579) |
| Accumulated loss | 47,047 |
| Accumulated other comprehensive loss | 46,468 |
| Net amount recognized in the consolidated balance sheet | (12,496) |
| Cumulative employer contributions in excess of net periodic benefit cost | $ 33,972 |

The following table illustrates the effects of the SFAS No. 158 adjustments on the consolidated balance sheet to record the funded status as of February 3, 2007:

| | Pre−SFAS 158 without AML adjustment | AML Adjustment | Pre−SFAS 158 with AML adjustment | SFAS 158 adoption adjustments | Post SFAS 158 |
|---|---|---|---|---|---|
| Prepaid pension asset | $ 47,668 | $ — | $ 47,668 | $ (43,115) | $ 4,553 |
| Accrued pension liability | 13,696 | 3,379 | 17,075 | (26) | 17,049 |
| Deferred tax asset | — | 1,049 | 1,049 | 17,073 | 18,122 |
| Accumulated OCI — pension, net of tax | — | 2,330 | 2,330 | 26,016 | 28,346 |
| Accumulated OCI — pension, pre−tax | — | 3,379 | 3,379 | 43,089 | 46,468 |

Plan weighted−average asset allocations at November 1, 2006 and 2005, by asset category were as follows:

| | November 1, 2006 | November 1, 2005 |
|---|---|---|
| Equity | 65.6% | 64.5% |
| Debt | 29.1% | 29.4% |
| Real estate | 5.0% | 5.6% |
| Other | 0.3% | 0.5% |
| Total | 100.0% | 100.0% |

The plan’s target allocation is determined taking into consideration the amounts and timing of projected liabilities, the Company’s funding policies and expected returns on various asset categories. At November 1, 2006 and 2005, the plan’s target asset allocation was approximately 65% equity, 30% fixed income and 5% real estate.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

At February 3, 2007, the following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| Year | Benefit Payments |
|---|---|
| 2007 | $ 18,463 |
| 2008 | 17,012 |
| 2009 | 16,186 |
| 2010 | 15,620 |
| 2011 | 14,960 |
| Thereafter | 57,892 |
| | $ 140,133 |

Pension assumptions are based upon management's best estimates, after consulting with outside investment advisors and actuaries, as of the annual measurement date.

- To the extent the discount rate increases or decreases, the Company's Accumulated Benefit Obligation (ABO) and Projected Benefit Obligation (PBO) are decreased or increased, respectively. The estimated effect of a 0.25% change in the discount rate is approximately $3,000 on the ABO and PBO and approximately $100 on annual pension expense. To the extent the ABO and PBO increases, the after−tax effect of such serves to reduce Other Comprehensive Income and reduce Shareholders' Equity.

- The Company's estimate of the expected long−term rate of return considers the historical returns on plan assets, as well as the future expectations of returns on classes of assets within the target asset allocation of the plan asset portfolio. To the extent the actual rate of return on assets realized is greater than the assumed rate, that year's annual pension expense is not affected. Rather, this gain reduces future pension expense over a period of approximately 10 years. To the extent the actual rate of return on assets is less than the assumed rate, that year's annual pension expense is likewise not affected. Rather, this loss increases pension expense over approximately 10 years. The Company's actual long−term rate of return on assets was 8.0% and 7.5% in 2006 and 2005, respectively.

- The average rate of compensation increases is utilized principally in calculating the Projected Benefit Obligation and annual pension expense. The estimated effect of a 0.25% change in the expected compensation increase would not be material to the Projected Benefit Obligation or to annual pension expense.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

**RETIREE HEALTH CARE PLANS**

In conjunction with the sale of NDSG, Bon−Ton assumed the liabilities of the Carson retiree health care plans. Prior to the sale of NDSG, the Company provided health care benefits for certain groups of NDSG employees who retired before 1997. The plans were contributory with the Company providing a frozen annual credit of varying amounts per year of service. The net annual expense and liabilities for the unfunded plans reflected in the Company's consolidated balance sheets are as follows:

| | 2005 |
|---|---|
| **Change in benefit obligation:** | |
| Benefit obligation at beginning of period (November 1) | $ 7,242 |
| Interest cost | 390 |
| Actuarial (gains) loss | (171) |
| Benefits paid | (748) |
| Benefit obligation at end of period (November 1) | $ 6,713 |
| **Plan funding status:** | |
| Accumulated post−retirement benefit obligation at November 1 | $ (6,713) |
| Fair value of plan assets at November 1 | — |
| Funded status at November 1 | (6,713) |
| Unrecognized actuarial gain | (3,791) |
| Contributions subsequent to measurement date | 339 |
| Accrued pension cost classified in other liabilities at balance sheet date | $(10,165) |
| **Sensitivity analysis:** | |
| Effect of a 1.0% increase in health care cost trend assumption on: | |
| Total service cost and interest cost components | $ 21 |
| Benefit obligations | $ 394 |
| Effect of a 1.0% decrease in health care cost trend assumption on: | |
| Total service cost and interest cost components | $ (19) |
| Benefit obligations | $ (356) |
| **Assumptions:** | |
| Discount rate, at end of period | 5.75% |
| Pre−Medicare medical inflation | 9.00% |
| Post−Medicare medical inflation | 9.00% |
| Ultimate medical inflation | 5.5% |
| Measurement date | 11/1/05 |

**NOTE 10 — SHAREHOLDERS' EQUITY**

On October 3, 2006 the Company's Board of Directors declared a cash dividend of $4.00 per common share, and the Company reduced shareholders' equity for the $558,587 dividend. Approximately $552,000 of the dividend was paid on November 30, 2006 to shareholders of record as of November 15, 2006. The remaining portion of the dividend payable will be paid prospectively as, and to the extent, awards of restricted stock and performance shares vest.

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

As a result of the November 30, 2006 $4.00 per common share dividend payment, the Human Resources and Compensation Committee of the Company's Board of Directors exercised its discretion under anti−dilution provisions of the Company's long−term incentive plan to adjust the exercise price and number of stock options to reflect the change in the share price on the December 1, 2006 ex−dividend date. In accordance with the provisions of SFAS 123R, "Accounting for Stock−Based Compensation," the discretionary nature of the anti−dilution provisions resulted in a modification of the options. Accordingly, the measurement of the fair value of the options both before and after the ex−dividend date was required resulting in a pre−tax non−cash charge of approximately $13,729.

The effect of this anti−dilution adjustment is presented below:

| | As of the ex−dividend date | |
|---|---|---|
| | Prior to Adjustment | After Adjustment |
| Options outstanding | 4,547 | 5,645 |
| Options exercisable | 4,489 | 5,573 |
| Weighted average exercise price: | | |
| Options outstanding | $14.49 | $ 11.67 |
| Options exercisable | $14.57 | $ 11.74 |

On March 6, 2006, the Company's Board of Directors declared a cash dividend of $4.00 per common share, and the Company reduced shareholders' equity for the $547,537 dividend. $538,964 of the dividend was paid on May 1, 2006 to shareholders of record as of April 14, 2006. The remaining portion of the dividend payable will be paid prospectively as, and to the extent, awards of restricted stock and performance shares vest.

As a result of the May 1, 2006 $4.00 per common share dividend payment, the Human Resources and Compensation Committee of the Company's Board of Directors exercised its discretion under anti−dilution provisions of the Company's long−term incentive plan to adjust the exercise price and number of stock options to reflect the change in the share price on the May 2, 2006 ex−dividend date. In accordance with the provisions of SFAS 123R, the discretionary nature of the anti−dilution provisions resulted in a modification of the options. Accordingly, the measurement of the fair value of the options before and after the ex−dividend date was required resulting in a pre−tax non−cash charge of approximately $19,600.

The effect of this anti−dilution adjustment is presented below:

| | As of the ex−dividend date | |
|---|---|---|
| | Prior to Adjustment | After Adjustment |
| Options outstanding | 7,148 | 8,845 |
| Options exercisable | 6,870 | 8,501 |
| Weighted average exercise price: | | |
| Options outstanding | $16.58 | $ 13.40 |
| Options exercisable | $16.82 | $ 13.59 |

(Dollar amounts in thousands, except per share amounts)

Table of Contents

Index to Financial Statements


On December 8, 2005, the Company announced that in anticipation of the closing of the NDSG transaction, its Board of Directors had approved a 35,000 share increase in its common share repurchase authorization, bringing the total number of authorized shares to 70,025. During 2006, 2005 and 2004, the Company repurchased 450, 12,860 and 6,203 shares for an aggregate amount of $6,531, $223,699 and $85,397, respectively. There were 37,380 shares available for repurchase under authorizations at February 3, 2007.

Each outstanding share of common stock has one preferred stock purchase right attached. The rights generally become exercisable ten days after an outside party acquires, or makes an offer for, 20% or more of the common stock. Each right entitles its holder to buy 1/200 share of Series C Junior Preferred Stock at an exercise price of $278 per 1/100 of a share, subject to adjustment in certain cases. The rights expire in March 2008. Once exercisable, if the Company is involved in a merger or other business combination or an outside party acquires 20% or more of the common stock, each right will be modified to entitle its holder (other than the acquirer) to purchase common stock of the acquiring company or, in certain circumstances, common stock having a market value of twice the exercise price of the right.

## NOTE 11 — EMPLOYEE STOCK PLANS

### STOCK OPTIONS AND GRANTS

The Company maintains an equity stock plan for the granting of options, stock appreciation rights, performance shares, restricted stock and other forms of equity awards to employees and directors. At February 3, 2007 and January 28, 2006, the Company had available for grant 18,138 and 9,931 shares of common stock, respectively. Options granted generally vest over a four−year period after grant and have an exercise term of seven to ten years from the grant date. Restricted stock and performance shares generally vest one to ten years after the grant date and in some cases with accelerated vesting at the discretion of the Company’s Board of Directors.

A summary of the stock option plans for 2006, 2005 and 2004 is presented below:

| | 2006 | | | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Weighted Average Exercise Price | Aggregate Intrinsic Value | Shares | Weighted Average Exercise Price | Aggregate Intrinsic Value | Shares | Weighted Average Exercise Price | Aggregate Intrinsic Value |
| Outstanding at beginning of year | 8,400 | $ 15.84 | | 17,954 | $ 13.60 | | 20,503 | $ 15.66 | |
| Dividend Adjustments | 2,795 | 3.92 | | — | 0.00 | | 2,332 | (1.70) | |
| Granted | — | 0.00 | | — | 0.00 | | 253 | 17.56 | |
| Exercised | (5,486) | 11.00 | | (8,171) | 17.42 | | (2,666) | 10.32 | |
| Forfeited | (848) | 20.21 | | (1,383) | 17.95 | | (2,468) | 21.21 | |
| Outstanding at end of year | 4,861 | $ 11.56 | $ 38,305 | 8,400 | $ 15.84 | $ 26,628 | 17,954 | $ 13.60 | $ 3,591 |
| Options exercisable at year end | 4,814 | $ 11.61 | $ 37,694 | 8,032 | $ 16.08 | $ 23,534 | 15,704 | $ 14.01 | $ 3,298 |
| Weighted average fair value of options granted during the year | | — | | | — | | | $7.44 | |

(Dollar amounts in thousands, except per share amounts)

The total intrinsic value of stock options exercised during 2006, 2005 and 2004 was $43,365, $55,534 and $12,639, respectively.

The following table summarizes information about stock options outstanding at February 3, 2007:

| | Options Outstanding | | | Options Exercisable | | |
|---|---|---|---|---|---|---|
| **Range of Exercise Prices** | **Number Outstanding at February 3, 2007** | **Weighted Average Remaining Contractual Life (Years)** | **Weighted Average Exercise Price** | **Number Exercisable at February 3, 2007** | **Weighted Average Remaining Contractual Life (Years)** | **Weighted Average Exercise Price** |
| $4.02 to $7.36 | 1,871 | 2.5 | $ 6.05 | 1,842 | 2.5 | $ 6.06 |
| $7.37 to $10.86 | 332 | 2.8 | $ 8.60 | 314 | 2.7 | $ 8.62 |
| $10.87 to $16.30 | 1,085 | 1.5 | $ 13.07 | 1,085 | 1.5 | $ 13.07 |
| $16.31 to $25.33 | 1,573 | 1.5 | $ 17.71 | 1,573 | 1.5 | $ 17.71 |
| | 4,861 | 2.0 | $ 11.56 | 4,814 | 2.0 | $ 11.61 |

Due to the Company’s inability to file certain periodic reports with the SEC during 2005, holders of stock options were precluded from exercising their stock options. As a result, the Company granted a 90−day extension for those employees who were terminated during this period, and the Company recorded a modification charge of approximately $2,300 in 2005.

The Company also granted restricted stock awards of 940, 805 and 1,716 shares to certain employees in 2006, 2005 and 2004, respectively. The fair value of these awards on the dates of grants was $18,311, $14,210 and $26,493 for 2006, 2005 and 2004, respectively. During 2006, 2005 and 2004, compensation cost of $18,722, $17,596 and $13,897, respectively, was recognized in connection with restricted stock awards. At February 3, 2007 and January 28, 2006, Company had unearned compensation amounts related to non−vested restricted stock of $7,694 and $19,672, respectively, included in Additional Paid−In Capital, which will be recognized over a weighted average period of 1 year.

A summary of restricted stock awards for 2006 is presented below:

| | **Shares** | **Weighted Average Grant Price** |
|---|---|---|
| Nonvested at January 28, 2006 | 2,440 | $ 14.48 |
| Granted | 940 | 19.48 |
| Vested | (574) | 11.40 |
| Canceled | (1,121) | 15.23 |
| Nonvested at February 3, 2007 | 1,685 | $ 18.01 |

**STOCK PURCHASE PLAN**

The Company’s employee stock purchase plan provides for an aggregate of 1,450 shares of the Company’s common stock to be purchased by eligible employees through payroll deductions at a 15% discount to market value. Under the plan, 40 ($576), 53 ($700) and 79 ($1,000) shares of the Company’s common stock were purchased by employees in 2006, 2005 and 2004, respectively. At February 3, 2007, the plan had 295 shares available for future offerings.

(Dollar amounts in thousands, except per share amounts)

## NOTE 12 — FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair values of the Company's cash and cash equivalents and accounts payable approximate their carrying amounts reported in the consolidated balance sheets, due to the immediate or short−term maturity of these instruments. For variable rate notes that reprice frequently, such as the revolving credit agreement, fair value approximates carrying value. The fair value of fixed rate real estate and mortgage notes is estimated using discounted cash flow analyses with interest rates currently offered for loans with similar terms and credit risk, and as of February 3, 2007 and January 28, 2006 the fair value of these notes approximated the carrying value.

The fair values of the Company's financial instruments other than the instruments considered short−term in nature at February 3, 2007 and January 28, 2006 were as follows:

| | Carrying Amount | Estimated Fair Value |
|---|---|---|
| February 3, 2007 | | |
| 8.25% senior notes | $ 190,324 | $ 198,888 |
| 7.50% senior notes | $ 45,872 | $ 46,216 |
| 9.875% senior notes | $ 141,557 | $ 159,252 |
| 7.00% senior notes | $ 3,022 | $ 3,022 |
| 7.375% senior notes | $ 1,911 | $ 1,911 |
| 2.00% convertible notes | $ 230,000 | $ 371,450 |
| January 28, 2006 | | |
| 8.25% senior notes | $ 190,324 | $ 195,082 |
| 7.50% senior notes | $ 45,872 | $ 44,955 |
| 9.875% senior notes | $ 141,557 | $ 156,941 |
| 7.00% senior notes | $ 3,022 | $ 2,893 |
| 7.375% senior notes | $ 2,104 | $ 2,018 |
| 2.00% convertible notes | $ 230,000 | $ 249,601 |

The fair values of the long−term debt were estimated based on quotes obtained from financial institutions for those or similar instruments or on the basis of quoted market prices. The estimated fair value of the convertible note hedge and written call option was approximately $13,300.

## NOTE 13 — STORE DISPOSITIONS, INTEGRATION AND OTHER CHARGES

In October 2004, the Company announced its intention to close 12 SFA stores. The net pre−tax charges resulting from closing these stores are principally related to asset impairments, lease terminations, inventory write downs and severance costs, partially offset by gains on the disposition of one or more stores. As it relates to these closings, the Company incurred net charges of $6,621 during the year ended February 3, 2007, primarily relating to lease termination costs at closed stores. The Company realized net gains of $1,068 during the fiscal year ended January 28, 2006, primarily resulting from net gains from the sale of closed stores, offset by severance charges, markdowns and other costs associated with the closings. During the fiscal year ended

SAKS INCORPORATED & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollar amounts in thousands, except per share amounts)

January 29, 2005, the Company incurred net charges of $28,142, primarily related to asset impairments, markdown charges, lease termination and continuing rental costs, and severance costs associated with the SFA store closings. Severance costs represent the portion of accrued benefits for employees that will exit when the stores are closed. Lease termination costs are included in Impairments and Dispositions, markdown charges are included in Gross Margin, and severance costs are included in Selling, General & Administrative Expenses in the accompanying Consolidated Statements of Income. There were no amounts payable related to these charges at February 3, 2007.

The Company continuously evaluates its real estate portfolio and closes individual underproductive stores in the normal course of business as leases expire or as other circumstances indicate. The Company also performs an asset impairment analysis at each fiscal year end. During the year ended February 3, 2007, January 28, 2006 and January 29, 2005, the Company incurred net charges of $6,344, $7,156 and $3,224, respectively, related to asset impairments and other costs. Asset impairments are included in Impairments and Dispositions and severance costs are included in Selling, General & Administrative Expenses in the accompanying Consolidated Statements of Income. There were no amounts payable related to these charges at February 3, 2007.

During the fiscal year ended January 28, 2006, the Company also recorded a $14,670 gain related to the insurance settlement on the SFA store in New Orleans which suffered substantial water, fire, and other damage related to Hurricane Katrina. The SFA New Orleans store is covered by both property damage and business interruption insurance. The property damage coverage has paid to repair and/or replace the physical property damage and inventory loss, and the business interruption coverage will reimburse the Company for lost profits as well as continuing expenses related to loss mitigation, recovery, and reconstruction for the full duration of the reconstruction period plus three months. The gain, which represents the excess of the replacement cost over the net book value of the property, was included in Impairments and Dispositions in the accompanying Consolidated Statements of Income. The Company reopened the store in the fourth quarter of 2006 after necessary repairs and renovations were made to the property. Subsequent to the re−opening of the store, the Company submitted its business interruption claim to its insurance carrier.

In 2005, the Company also recorded a $2,987 goodwill impairment charge related to CLL. This charge was included in Impairments and Dispositions in the accompanying Consolidated Statements of Income.

(Dollar amounts in thousands, except per share amounts)

Table of Contents

Index to Financial Statements


**NOTE 14 — QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

Summarized quarterly financial information for 2006 and 2005 is as follows:

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| Fiscal year ended February 3, 2007: | | | | |
| Total sales | $684,129 | $603,833 | $697,041 | $955,000 |
| Gross margin | 282,858 | 198,504 | 292,431 | 361,916 |
| Operating income (loss) | 12,166 | (77,040) | 26,487 | 17,984 |
| Income (loss) from continuing operations | 11,660 | (53,096) | 12,478 | 21,616 |
| Net income (loss) | 77,898 | (51,855) | 6,178 | 21,521 |
| Basic earnings (loss) per common share | $ 0.58 | $ (0.38) | $ 0.05 | $ 0.16 |
| Diluted earnings (loss) per common share | $ 0.57 | $ (0.38) | $ 0.05 | $ 0.14 |

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| Fiscal year ended January 28, 2006: | | | | |
| Total sales | $715,081 | $600,327 | $645,152 | $817,773 |
| Gross margin | 287,727 | 197,139 | 263,995 | 274,639 |
| Operating income (loss) | 4,167 | (85,326) | (9,868) | (36,919) |
| Income (loss) from continuing operations | (11,162) | (79,050) | (13,548) | (29,883) |
| Net income (loss) | 16,171 | 8,194 | 225 | (2,242) |
| Basic earnings (loss) per common share | $ 0.12 | $ 0.06 | $ 0.00 | $ (0.02) |
| Diluted earnings (loss) per common share | $ 0.11 | $ 0.06 | $ 0.00 | $ (0.02) |

**NOTE 15 — CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

The following tables present condensed consolidating financial information for 2006, 2005 and 2004 for: (1) Saks Incorporated and (2) on a combined basis, the guarantors of Saks Incorporated's senior notes (which are all of the wholly owned subsidiaries of Saks Incorporated).

The condensed consolidating financial statements presented as of and for the years ended February 3, 2007, January 28, 2006 and January 29, 2005 reflect the legal entity compositions at the respective dates.

Separate financial statements of the guarantor subsidiaries are not presented because the guarantors are jointly, severally, fully and unconditionally liable under the guarantees. Borrowings and the related interest expense under the Company's revolving credit agreement are allocated to Saks Incorporated and the guarantor subsidiaries under an intercompany revolving credit arrangement. There are also management and royalty fee arrangements among Saks Incorporated and the subsidiaries. At February 3, 2007, Saks Incorporated was the sole obligor for a majority of the Company's long−term debt and maintained a small group of corporate employees.

Table of Contents

Index to Financial Statements

SAKS INCORPORATED & SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF INCOME

FOR THE YEAR ENDED FEBRUARY 3, 2007

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **NET SALES** | | $ 2,940,003 | | $ 2,940,003 |
| Cost of sales | | 1,804,294 | | 1,804,294 |
| **GROSS MARGIN** | | 1,135,709 | | 1,135,709 |
| Selling, general and administrative expenses | $ 6,601 | 812,617 | | 819,218 |
| Other operating expenses | 128 | 323,726 | | 323,854 |
| Store pre−opening costs | | 597 | | 597 |
| Impairments and dispositions | | 12,443 | | 12,443 |
| **OPERATING LOSS** | (6,729) | (13,674) | — | (20,403) |
| **OTHER INCOME (EXPENSE)** | | | | |
| Equity in earnings of subsidiaries — continuing operations | (14,021) | | $ 14,021 | |
| Interest expense | (40,442) | (9,694) | | (50,136) |
| Gain on extinguishment of debt | 7 | | | 7 |
| Other income, net | 28,407 | | | 28,407 |
| **LOSS FROM CONTINUING OPERATIONS BEFORE BENEFIT FOR INCOME TAXES** | (32,778) | (23,368) | 14,021 | (42,125) |
| Benefit for income taxes | (25,436) | (9,347) | | (34,783) |
| **LOSS FROM CONTINUING OPERATIONS DISCONTINUED OPERATIONS:** | (7,342) | (14,021) | 14,021 | (7,342) |
| Equity in earnings of subsidiaries — discontinued operations (net of tax) | 61,084 | | (61,084) | — |
| Income from discontinued operations (including gain on disposal of $191,918) | | 193,377 | | 193,377 |
| Provision for income taxes | | 132,293 | | 132,293 |
| **INCOME FROM DISCONTINUED OPERATIONS** | 61,084 | 61,084 | (61,084) | 61,084 |
| **NET INCOME** | $ 53,742 | $ 47,063 | $ (47,063) | $ 53,742 |

Table of Contents

Index to Financial Statements

SAKS INCORPORATED & SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEETS

AS OF FEBRUARY 3, 2007

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **CURRENT ASSETS** | | | | |
| Cash and cash equivalents | $ 265,508 | $ 12,375 | | $ 277,883 |
| Merchandise inventories | | 785,302 | | 785,302 |
| Other current assets | | 146,893 | | 146,893 |
| Deferred income taxes, net | | 40,763 | | 40,763 |
| **TOTAL CURRENT ASSETS** | 265,508 | 985,333 | | 1,250,841 |
| **PROPERTY AND EQUIPMENT, NET** | | 1,099,331 | | 1,099,331 |
| **GOODWILL AND INTANGIBLES, NET** | | 324 | | 324 |
| **DEFERRED INCOME TAXES, NET** | | 152,754 | | 152,754 |
| **OTHER ASSETS** | 11,126 | 29,927 | | 41,053 |
| **INVESTMENT IN AND ADVANCES TO SUBSIDIARIES** | 1,454,660 | | (1,454,660) | |
| | $ 1,731,294 | $ 2,267,669 | $ (1,454,660) | $ 2,544,303 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | |
| **CURRENT LIABILITIES** | | | | |
| Accounts payable | | $ 231,038 | | $ 231,038 |
| Accrued expenses and other current liabilities | $ 22,552 | 372,523 | | 395,075 |
| Current portion of long−term debt | 230,000 | 6,667 | | 236,667 |
| **TOTAL CURRENT LIABILITIES** | 252,552 | 610,228 | | 862,780 |
| **LONG−TERM DEBT** | 382,336 | 67,674 | | 450,010 |
| **OTHER LONG−TERM LIABILITIES** | 267 | 135,107 | | 135,374 |
| **INVESTMENT BY AND ADVANCES FROM PARENT** | | 1,454,660 | (1,454,660) | |
| **SHAREHOLDERS' EQUITY** | 1,096,139 | | | 1,096,139 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | $ 1,731,294 | $ 2,267,669 | $ (1,454,660) | $ 2,544,303 |

Table of Contents

Index to Financial Statements

SAKS INCORPORATED & SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED FEBRUARY 3, 2007

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **OPERATING ACTIVITIES** | | | | |
| Net income | $ 53,742 | $ 47,063 | $ (47,063) | $ 53,742 |
| Income from discontinued operations | 61,084 | 61,084 | (61,084) | 61,084 |
| Loss from continuing operations | (7,342) | (14,021) | 14,021 | (7,342) |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | | | |
| Equity in earnings of subsidiaries | 14,021 | | (14,021) | |
| Depreciation and amortization | — | 128,522 | | 128,522 |
| Provision for employee stock compensation | 52,072 | | | 52,072 |
| Excess tax benefit from stock−based compensation | (16,027) | | | (16,027) |
| Deferred income taxes | | 93,987 | | 93,987 |
| Loss on extinguishment of debt | (7) | | | (7) |
| Impairments and dispositions | | 12,443 | | 12,443 |
| Changes in operating assets and liabilities, net | 15,206 | (127,839) | | (112,633) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES — CONTINUING OPERATIONS** | 57,923 | 93,092 | — | 151,015 |
| **NET CASH USED IN OPERATING ACTIVITIES — DISCONTINUED OPERATIONS** | | (95,730) | | (95,730) |
| **NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | 57,923 | (2,638) | — | 55,285 |
| **INVESTING ACTIVITIES** | | | | |
| Purchases of property and equipment | | (123,679) | | (123,679) |
| Proceeds from sale of assets | | 171 | | 171 |
| **NET CASH USED IN INVESTING ACTIVITIES — CONTINUING OPERATIONS** | — | (123,508) | — | (123,508) |
| **NET CASH PROVIDED BY INVESTING ACTIVITIES —DISCONTINUED OPERATIONS** | | 1,307,025 | | 1,307,025 |
| **NET CASH PROVIDED BY INVESTING ACTIVITIES** | — | 1,183,517 | — | 1,183,517 |
| **FINANCING ACTIVITIES** | | | | |
| Intercompany borrowings | 1,195,647 | (1,195,647) | | |
| Payments on long−term debt | (263) | (7,108) | | (7,371) |
| Payment of dividend | (1,095,025) | | | (1,095,025) |
| Excess tax benefit from stock−based compensation | 16,027 | | | 16,027 |
| Proceeds from issuance of stock | (6,531) | | | (6,531) |
| Purchases and retirements of common stock | 51,730 | | | 51,730 |
| **NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES — CONTINUING OPERATIONS** | 161,585 | (1,202,755) | — | (1,041,170) |
| **NET CASH USED IN FINANCING ACTIVITIES — DISCONTINUED OPERATIONS** | | (149) | | (149) |
| **NET CASH USED IN FINANCING ACTIVITIES** | 161,585 | (1,202,904) | — | (1,041,319) |
| **INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | 219,508 | (22,025) | — | 197,483 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 46,000 | 31,312 | | 77,312 |
| **PLUS: CASH AND CASH EQUIVALENTS INCLUDED IN ASSETS HELD FOR SALE AT END OF YEAR** | | 3,088 | | 3,088 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 265,508 | $ 12,375 | $ — | $ 277,883 |

Table of Contents

Index to Financial Statements

SAKS INCORPORATED & SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF INCOME

FOR THE YEAR ENDED JANUARY 28, 2006

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **NET SALES** | | $ 2,778,333 | | $ 2,778,333 |
| Cost of sales | | 1,754,833 | | 1,754,833 |
| **GROSS MARGIN** | | 1,023,500 | | 1,023,500 |
| Selling, general and administrative expenses | $ 7,408 | 823,087 | | 830,495 |
| Other operating expenses | 124 | 327,448 | | 327,572 |
| Store pre−opening costs | | 1,227 | | 1,227 |
| Impairments and dispositions | | (7,848) | | (7,848) |
| **OPERATING LOSS** | (7,532) | (120,414) | — | (127,946) |
| **OTHER INCOME (EXPENSE)** | | | | |
| Equity in earnings of subsidiaries — continuing operations | (79,033) | | $ 79,033 | |
| Interest expense | (63,648) | (13,540) | | (77,188) |
| Loss on extinguishment of debt | (29,375) | | | (29,375) |
| Other income, net | 7,705 | | | 7,705 |
| **LOSS FROM CONTINUING OPERATIONS BEFORE BENEFIT FOR INCOME TAXES** | (171,883) | (133,954) | 79,033 | (226,804) |
| Benefit for income taxes | (38,240) | (54,921) | | (93,161) |
| **LOSS FROM CONTINUING OPERATIONS** | (133,643) | (79,033) | 79,033 | (133,643) |
| **DISCONTINUED OPERATIONS:** | | | | |
| Equity in earnings of subsidiaries — discontinued operations (net of tax) | 153,773 | | (153,773) | — |
| Income from discontinued operations (including gain on disposal of $156,010) | 3,760 | 317,683 | | 321,443 |
| Provision for income taxes | 1,542 | 163,910 | | 165,452 |
| **INCOME FROM DISCONTINUED OPERATIONS** | 155,991 | 153,773 | (153,773) | 155,991 |
| **NET INCOME** | $ 22,348 | $ 74,740 | $ (74,740) | $ 22,348 |

Table of Contents

Index to Financial Statements

SAKS INCORPORATED & SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEETS

AS OF JANUARY 28, 2006

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **CURRENT ASSETS** | | | | |
| Cash and cash equivalents | $ 46,000 | $ 31,312 | | $ 77,312 |
| Merchandise inventories | 4,225 | 802,986 | | 807,211 |
| Other current assets | | 165,085 | | 165,085 |
| Deferred income taxes, net | | 119,558 | | 119,558 |
| Current assets — held for sale | | 475,485 | | 475,485 |
| **TOTAL CURRENT ASSETS** | 50,225 | 1,594,426 | | 1,644,651 |
| **PROPERTY AND EQUIPMENT, NET** | 4,098 | 1,336,770 | | 1,340,868 |
| **PROPERTY AND EQUIPMENT, NET — HELD FOR SALE** | | 436,412 | | 436,412 |
| **GOODWILL AND INTANGIBLES, NET** | | 181,644 | | 181,644 |
| **GOODWILL AND INTANGIBLES, NET — HELD FOR SALE** | | 1,789 | | 1,789 |
| **DEFERRED INCOME TAXES, NET** | | 191,480 | | 191,480 |
| **OTHER ASSETS** | 13,737 | 28,812 | | 42,549 |
| **OTHER ASSETS — HELD FOR SALE** | | 11,332 | | 11,332 |
| **INVESTMENT IN AND ADVANCES TO SUBSIDIARIES** | 2,558,067 | | (2,558,067) | |
| | $ 2,626,127 | $ 3,782,665 | $ (2,558,067) | $ 3,850,725 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | |
| **CURRENT LIABILITIES** | | | | |
| Accounts payable | $ 1,056 | $ 189,008 | | $ 190,064 |
| Accrued expenses and other current liabilities | 12,793 | 437,322 | | 450,115 |
| Current portion of long−term debt | — | 7,803 | | 7,803 |
| Current liabilities — held for sale | | 197,068 | | 197,068 |
| **TOTAL CURRENT LIABILITIES** | 13,849 | 831,201 | | 845,050 |
| **LONG−TERM DEBT** | 612,295 | 75,785 | | 688,080 |
| **LONG−TERM DEBT — HELD FOR SALE** | | 34,656 | | 34,656 |
| **OTHER LONG−TERM LIABILITIES** | 600 | 202,983 | | 203,583 |
| **OTHER LONG−TERM LIABILITIES — HELD FOR SALE** | | 79,973 | | 79,973 |
| **INVESTMENT BY AND ADVANCES FROM PARENT** | | 2,558,067 | (2,558,067) | |
| **SHAREHOLDERS' EQUITY** | 1,999,383 | | | 1,999,383 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | $ 2,626,127 | $ 3,782,665 | $ (2,558,067) | $ 3,850,725 |

Table of Contents

Index to Financial Statements

**SAKS INCORPORATED & SUBSIDIARIES**

**CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS**

**FOR THE YEAR ENDED JANUARY 28, 2006**

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **OPERATING ACTIVITIES** | | | | |
| Net income | $ 22,348 | $ 74,740 | $ (74,740) | $ 22,348 |
| Income from discontinued operations | 155,991 | 153,773 | (153,773) | 155,991 |
| Loss from continuing operations | (133,643) | (79,033) | 79,033 | (133,643) |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | |
| Equity in earnings of subsidiaries — continuing operations | 79,033 | | (79,033) | |
| Depreciation and amortization | 791 | 132,765 | | 133,556 |
| Provision for employee stock compensation | 17,595 | | | 17,595 |
| Deferred income taxes | | 37,262 | | 37,262 |
| Loss on extinguishment of debt | 29,375 | | | 29,375 |
| Impairments and dispositions | | (7,848) | | (7,848) |
| Changes in operating assets and liabilities, net | (39,178) | (1,847) | | (41,025) |
| **NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES — CONTINUING OPERATIONS** | (46,027) | 81,299 | — | 35,272 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES — DISCONTINUED OPERATIONS** | 2,218 | 150,582 | | 152,800 |
| **NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | (43,809) | 231,881 | — | 188,072 |
| **INVESTING ACTIVITIES** | | | | |
| Purchases of property and equipment | | (130,124) | | (130,124) |
| Proceeds from sale of assets | | 13,236 | | 13,236 |
| **NET CASH USED IN INVESTING ACTIVITIES — CONTINUING OPERATIONS** | — | (116,888) | — | (116,888) |
| **NET CASH PROVIDED BY INVESTING ACTIVITIES — DISCONTINUED OPERATIONS** | | 514,599 | | 514,599 |
| **NET CASH PROVIDED BY INVESTING ACTIVITIES** | — | 397,711 | — | 397,711 |
| **FINANCING ACTIVITIES** | | | | |
| Intercompany borrowings | 625,896 | (625,896) | | |
| Payments on long−term debt and capital lease obligations | (607,158) | (14,158) | | (621,316) |
| Cash dividends paid | (795) | | | (795) |
| Proceeds from issuance of common stock | 83,508 | | | 83,508 |
| Purchases and retirements of common stock | (223,643) | | | (223,643) |
| **NET CASH USED IN FINANCING ACTIVITIES — CONTINUING OPERATIONS** | (122,192) | (640,054) | — | (762,246) |
| **NET CASH USED IN FINANCING ACTIVITIES — DISCONTINUED OPERATIONS** | | (241) | | (241) |
| **NET CASH USED IN FINANCING ACTIVITIES** | (122,192) | (640,295) | — | (762,487) |
| **DECREASE IN CASH AND CASH EQUIVALENTS** | (166,001) | (10,703) | — | (176,704) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 212,001 | 45,103 | | 257,104 |
| **LESS: CASH AND CASH EQUIVALENTS INCLUDED IN ASSETS HELD FOR SALE AT END OF YEAR** | | (3,088) | | (3,088) |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 46,000 | $ 31,312 | $ — | $ 77,312 |

SAKS INCORPORATED & SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF INCOME

FOR THE YEAR ENDED JANUARY 29, 2005

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **NET SALES** | | $ 2,766,977 | | $ 2,766,977 |
| Cost of sales | | 1,681,297 | | 1,681,297 |
| **GROSS MARGIN** | | 1,085,680 | | 1,085,680 |
| Selling, general and administrative expenses | $ 5,394 | 791,180 | | 796,574 |
| Other operating expenses | 4,770 | 312,080 | | 316,850 |
| Store pre−opening costs | | 1,993 | | 1,993 |
| Impairments and dispositions | | 20,768 | | 20,768 |
| **OPERATING LOSS** | (10,164) | (40,341) | — | (50,505) |
| **OTHER INCOME (EXPENSE)** | | | | |
| Equity in earnings of subsidiaries — continuing operations | (28,942) | | $ 28,942 | |
| Interest expense | (88,591) | (16,182) | | (104,773) |
| Other income, net | 4,048 | | | 4,048 |
| **LOSS FROM CONTINUING OPERATIONS BEFORE BENEFIT FOR INCOME TAXES** | (123,649) | (56,523) | 28,942 | (151,230) |
| Benefit for income taxes | (43,443) | (27,581) | | (71,024) |
| **LOSS FROM CONTINUING OPERATIONS** | (80,206) | (28,942) | 28,942 | (80,206) |
| **DISCONTINUED OPERATIONS:** | | | | |
| Equity in earnings of subsidiaries — discontinued operations (net of tax) | 139,658 | | (139,658) | — |
| Income from discontinued operations | 2,592 | 232,876 | | 235,468 |
| Provision for income taxes | 959 | 93,218 | | 94,177 |
| **INCOME FROM DISCONTINUED OPERATIONS** | 141,291 | 139,658 | (139,658) | 141,291 |
| **NET INCOME** | $ 61,085 | $ 110,716 | $ (110,716) | $ 61,085 |

## SAKS INCORPORATED & SUBSIDIARIES

## CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

## FOR THE YEAR ENDED JANUARY 29, 2005

| (In Thousands) | SAKS INCORPORATED | GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLIDATED |
|---|---|---|---|---|
| **OPERATING ACTIVITIES** | | | | |
| Net income | $ 61,085 | $ 110,716 | $ (110,716) | $ 61,085 |
| Income from discontinued operations | 141,291 | 139,658 | (139,658) | 141,291 |
| Loss from continuing operations | (80,206) | (28,942) | 28,942 | (80,206) |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | |
| Equity in earnings of subsidiaries — continuing operations | 28,942 | | (28,942) | |
| Depreciation and amortization | 1,093 | 129,038 | | 130,131 |
| Provision for employee stock compensation | 13,897 | | | 13,897 |
| Deferred income taxes | | 6,744 | | 6,744 |
| Impairments and dispositions | | 20,768 | | 20,768 |
| Changes in operating assets and liabilities, net | (259) | (42,283) | | (42,542) |
| **NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES — CONTINUING OPERATIONS** | (36,533) | 85,325 | — | 48,792 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES — DISCONTINUED OPERATIONS** | 1,633 | 308,396 | | 310,029 |
| **NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | (34,900) | 393,721 | — | 358,821 |
| **INVESTING ACTIVITIES** | | | | |
| Purchases of property and equipment | | (96,013) | | (96,013) |
| Proceeds from sale of assets | | 17,183 | | 17,183 |
| **NET CASH USED IN INVESTING ACTIVITIES —CONTINUING OPERATIONS** | — | (78,830) | — | (78,830) |
| **NET CASH USED IN INVESTING ACTIVITIES — DISCONTINUED OPERATIONS** | | (97,642) | | (97,642) |
| **NET CASH USED IN INVESTING ACTIVITIES** | — | (176,472) | — | (176,472) |
| **FINANCING ACTIVITIES** | | | | |
| Intercompany borrowings | 204,146 | (204,146) | | — |
| Proceeds from issuance of convertible senior notes | 230,000 | | | 230,000 |
| Payments for hedge and call options associated with convertible notes | (25,043) | | | (25,043) |
| Payments on long−term debt and capital lease obligations | (142,649) | (6,503) | | (149,152) |
| Cash dividends paid | (283,127) | | | (283,127) |
| Proceeds from issuance of common stock | 27,971 | | | 27,971 |
| Purchases and retirements of common stock | (85,397) | | | (85,397) |
| **NET CASH USED IN FINANCING ACTIVITIES — CONTINUING OPERATIONS** | (74,099) | (210,649) | — | (284,748) |
| **NET CASH USED IN FINANCING ACTIVITIES —DISCONTINUED OPERATIONS** | | (6,370) | | (6,370) |
| **NET CASH USED IN FINANCING ACTIVITIES** | (74,099) | (217,019) | — | (291,118) |
| **INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | (108,999) | 230 | — | (108,769) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 321,000 | 44,873 | | 365,873 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 212,001 | $ 45,103 | $ — | $ 257,104 |

**Report of Independent Registered Public Accounting Firm on**

**Financial Statement Schedule**

To the Board of Directors

Of Saks Incorporated:

Our audits of the consolidated financial statements, of management's assessment of the effectiveness of internal control over financial reporting and of the effectiveness of internal control over financial reporting referred to in our report dated April 2, 2007 (appearing in this annual report on Form 10−K) also included an audit of the financial statement schedule listed in Item 15(a)(2) of this Form 10−K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

Birmingham, Alabama

April 2, 2007

**SAKS INCORPORATED & SUBSIDIARIES**

**SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS**

| | Year Ended | | |
|---|---|---|---|
| **(Dollars In Thousands)** | **February 3, 2007** | **January 28, 2006** | **January 29, 2005** |
| Allowance for sales returns, net: | | | |
| Balance at Beginning of Year | $ 8,645 | $ 9,975 | $ 5,771 |
| Charged to Costs and Expenses | 1,003,822 | 1,315,790 | 1,320,625 |
| Reserve related to sold Proffitt's and Parisian businesses | (1,155) | (848) | — |
| Reserve related to sold NDSG business | (2,335) | | |
| Deductions (A) | (1,002,129) | (1,316,272) | (1,316,421) |
| Balance at End of Year | $ 6,848 | $ 8,645 | $ 9,975 |

(A) Deductions consist of actual returns net of related costs and commissions

| | Year Ended | | |
|---|---|---|---|
| **(Dollars In Thousands)** | **February 3, 2007** | **January 28, 2006** | **January 29, 2005** |
| Valuation Allowance in Deferred Tax Assets | | | |
| Balance at Beginning of Year | $ 47,104 | $ 65,508 | $ 167,541 |
| Charged (Credited) to Income | (1,465) | 1,161 | (10,138) |
| Charged (Credited) to Shareholders' Equity | — | (2,525) | (71,078) |
| Increase (Decrease) to Reserve | 1,953 | (17,040) | (20,817) |
| Balance at End of Year | $ 47,592 | $ 47,104 | $ 65,508 |

# AMENDED AND RESTATED CHARTER

# OF

# SAKS INCORPORATED

(As amended effective December 8, 2005)

## ARTICLE I

## Name

The name of the Corporation is SAKS INCORPORATED.

## ARTICLE II

## Duration

The duration of the Corporation is perpetual.

## ARTICLE III

## Address

The address of the principal office of the Corporation is 750 Lakeshore Parkway, Birmingham, Alabama 35211.

## ARTICLE IV

## For Profit

The corporation is for profit.

## ARTICLE V

## Purpose

The purpose or purposes for which the Corporation are organized are:

(a) To purchase, rent, lease, construct or otherwise acquire adequate facilities and to operate therein general department stores and related services enterprises.

(b) To enter into partnerships and/or joint ventures with individuals, partnerships and/or corporations for the purpose of transacting and carrying out the business which the Corporation is authorized to conduct.

(c) To borrow or raise money for any of the purposes of the Corporation and to issue, make, and/or draw notes, drafts, warrants, bonds, debentures and/or other negotiable or non−negotiable instruments and to secure the payment thereof by mortgage, pledge, conveyance, deed of trust and/or other instrument upon any property of the Corporation.

(d) To perform such other acts and things as may be necessary and/or incident to any of the purposes aforesaid.

(e) To engage in any other lawful business permitted under the Tennessee General Corporation Act.

## ARTICLE VI

### Shares

The maximum number of shares of all classes of stock which the Corporation shall have the authority to issue is 510,000,000 shares consisting of (a) 10,000,000 shares of Series Preferred Stock, with a par value of $1.00 per share (herein called the "Series Preferred Stock"), and (b) 500,000,000 shares of Common Stock, with a par value of $.10 per share (herein called the "Common Stock").

The following is a statement of the powers, preferences and rights, and the qualifications, limitations or restrictions thereof, in respect to each class of stock of the Corporation.

Section 1. Series Preferred Stock.

1A. Conditions of Issuance. Series Preferred Stock may be issued from time to time and in such amounts and for such consideration as may be determined by the Board of Directors of the Corporation ("Board"). The designation and relative rights and preferences of each series, except to the extent such designations and relative rights and preferences may be required by Tennessee law or this Charter, shall be such as are fixed by the Board and stated in a resolution or resolutions adopted by the Board authorizing such series (herein called the "Series Resolution"). A Series Resolution authorizing any series shall fix:

(i) The designation of the series which may be by distinguishing number, letter or title;

(ii) The number of shares of such series;

(iii) The dividend rate or rates of such shares, the date at which dividends, if declared, shall be payable, and whether or not such dividends are to be cumulative, in which case such Series Resolution shall state the date or dates from which dividends shall be cumulative;

(iv) The amounts payable on shares of such series in the event of voluntary or involuntary liquidation, dissolution or winding up;

(v) The redemption rights and price or prices, if any, for the shares of such series;

(vi) The terms and amount of any sinking fund or analogous fund providing for the purchase or redemption of the shares of such series, if any;

(vii) The voting rights, if any, granted to the holders of the shares of such series in addition to those required by Tennessee law or this Charter;

(viii) Whether the shares of such series shall be convertible into shares of the Corporation's Common Stock or any other class of the Corporation's capital stock, and if convertible, the conversion price or prices, any adjustment thereof and any other terms and conditions upon which such conversion shall be made; and

(ix) Any other rights, preferences, restrictions or conditions relative to the shares of such series as may be permitted by Tennessee law or this Charter.

1B. Restrictions. In no event, so long as any Series Preferred Stock shall remain outstanding, shall any dividend whatsoever be declared or paid upon, nor shall any distribution be made upon, the Common Stock, other than a dividend or distribution payable in shares of such Common Stock, nor (without the written consent of such number of the holders of the outstanding Series Preferred Stock as shall have been specified in the Series Resolution authorizing the issuance of such outstanding Series Preferred Stock) shall any shares of Common Stock be purchased or redeemed by the Corporation, nor shall any monies be paid to or made available for a sinking fund for the purchase or redemption of any Common Stock, unless in each instance full dividends on all outstanding shares of the Series Preferred Stock for all past dividend periods shall have been paid and the full dividend on all outstanding shares of the Series Preferred Stock for the current dividend period shall have been paid or declared and sufficient funds for the payment thereof set apart and any arrears in the mandatory redemption of the Series Preferred Stock shall have been made good.

1C. Priority. Series Preferred Stock, with respect to both dividends and distribution of assets on liquidation, dissolution or winding up, shall rank prior to the Common Stock.

1D. Voting Rights. Holders of Series Preferred Stock shall have no right to vote for the election of directors of the Corporation or on any other matter unless a vote of such class is required by Tennessee law, this Charter or a Series Resolution.

1E. Filing of Amendments. The Board shall adopt amendments to this Charter fixing, with respect to each series of Series Preferred Stock, the matters described in Paragraph 1A of this Section 1.

1F. Series C Junior Preferred Stock. A series of authorized preferred stock is hereby established having a par value of $1.00 per share, which series shall be designated as "Series C Junior Preferred Stock" (the "Series C Junior Preferred Stock"), shall consist of 2,500,000 shares and shall have the following voting powers, preferences and relative, participating, optional and other special rights, and the qualifications, limitations and restrictions thereof as follows:

(i) Dividends and Distributions.

(a) Subject to the rights of the holders of any shares of any series of Preferred Stock (or any similar stock) ranking prior and superior to the Series C Junior Preferred Stock with respect to dividends, the holders of shares of Series C Junior Preferred Stock, in preference to the holders of Common Stock of the Corporation, and of any other junior stock, shall be entitled to receive, when, as and if declared by the Board out of funds legally available for the purpose, quarterly dividends payable in cash on the first day of March, June, September and December in each year (each such date being referred to herein as a "Quarterly Dividend Payment Date"), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series C Junior Preferred Stock in an amount per share (rounded to the nearest cent) equal to the greater of (a) $1.00 or (b) subject to the provision for adjustment hereinafter set forth, 100 times the aggregate per share amount of all cash dividends, and 100 times the aggregate per share amount (payable in kind) of all non−cash dividends or other distributions, other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series C Junior Preferred Stock. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount to which holders of shares of Series C Junior Preferred Stock were entitled immediately prior to such event under clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(b) The Corporation shall declare a dividend or distribution on the Series C Junior Preferred Stock as provided in paragraph (a) of this Section immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided that, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of $1.00 per share on the Series C Junior Preferred stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(c) Dividends shall begin to accrue and be cumulative on outstanding shares of Series C Junior Preferred Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case, dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series C Junior Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series C Junior Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share−by−share basis among all such shares at the time outstanding. The Board may fix a record date for the determination of holders of shares of Series C Junior Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than sixty (60) days prior to the date fixed for the payment thereof.

(ii) Voting Rights. The holders of shares of Series C Junior Preferred Stock shall have the following voting rights:

(a) Subject to the provision for adjustment hereinafter set forth, each share of Series C Junior Preferred Stock shall entitle the holder thereof to 100 votes on all matters submitted to a vote of the shareholders of the Corporation. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the number of votes per share to which holders of shares of Series C Junior Preferred Stock were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(b) Except as otherwise provided herein, in any other Articles of Amendment creating a series of Preferred Stock or any similar stock, or Bylaw, the holders of shares of Series C Junior Preferred Stock and the holders of shares of Common Stock and any other capital stock of the Corporation having general voting rights shall vote together as one class on all matters submitted to a vote of stockholders of the Corporation.

(c) Except as set forth herein, or as otherwise provided by law, holders of Series C Junior Preferred Stock shall have no special voting rights and their consent shall not be required (except to the extent they are entitled to vote with holders of Common Stock as set forth herein) for taking any corporate action.

(iii) Certain Restrictions.

(a) Whenever quarterly dividends or other dividends or distributions payable on the Series C Junior Preferred Stock as provided in Section 1 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series C Junior Preferred Stock outstanding shall have been paid in full, the Corporation shall not:

(1) declare or pay dividends, or make any other distributions, on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series C Junior Preferred Stock;

(2) declare or pay dividends, or make any other distributions, on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series C Junior Preferred Stock, except dividends paid ratably on the Series C Junior Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;

(3) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series C Junior Preferred Stock, provided that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Corporation ranking junior (as to dividends and upon dissolution, liquidation and winding up) to the Series C Junior Preferred Stock; or

(4) redeem or purchase or otherwise acquire for consideration any shares of Series C Junior Preferred Stock, or any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series C Junior Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board) to all holders of such shares upon such terms as the Board, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(b) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Company unless the Corporation could, under paragraph (a) of this Section 1F(iii), purchase or otherwise acquire such shares at such time and in such manner.

(iv) Reacquired Shares. Any shares of Series C Junior Preferred Stock purchased or otherwise acquired by the Company in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of Preferred Stock and may be reissued as part of a new series of Preferred Stock subject to the conditions and restrictions on issuance set forth herein, in the Charter, or in any other Articles of Amendment creating a series of Preferred Stock or any similar stock or otherwise required by law.

(v) Liquidation Dissolution or Winding Up. Upon any liquidation, dissolution or winding up of the Corporation, no distribution shall be made (1) to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series C Junior Preferred Stock unless, prior thereto, the holders of shares of Series C Junior Preferred Stock shall have received $1.00 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment, provided that the holders of shares of Series C Junior Preferred Stock shall be entitled to receive an aggregate amount per share, subject to the provision for adjustment hereinafter set forth, equal to 100 times the aggregate amount to be distributed per share to holders of shares of Common Stock, or (2) to the holders of shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series C Junior Preferred Stock except distributions made ratably on the Series C Junior Preferred Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled upon such liquidation, dissolution or winding up. In the event the Corporation shall, at any time, declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the aggregate amount to which holders of shares of Series C Junior Preferred Stock were entitled immediately prior to such event under the proviso in clause (1) of the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(vi) Consolidation, Merger, etc. In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case each share of Series C Junior Preferred Stock shall at the same time be similarly exchanged or changed into an amount per share, subject to the provision for adjustment hereinafter set forth, equal to 100 times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series C Junior Preferred Stock shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(vii) No Redemption. The shares of Series C Junior Preferred Stock shall not be redeemable.

(viii) Rank. The Series C Junior Preferred Stock shall rank, with respect to the payment of dividends and the distribution of assets, junior to all series of any other class of the Corporation's Preferred Stock.

(ix) Amendment. The Charter of the Corporation shall not be amended in any manner which would materially alter or change the powers, preferences or special rights of the Series C Junior Preferred Stock so as to affect them adversely without the affirmative vote of the holders of at least a majority of the outstanding shares of Series C Junior Preferred Stock, voting together as a single class.

Section 2. Common Stock. All shares of Common Stock shall be identical and shall entitle the holders thereof to the same rights and privileges.

2A. Dividends. When and as dividends are declared upon the Common Stock, whether payable in cash, in property or in shares of stock of the Corporation, the holders of the Common Stock shall be entitled to share equally, share per share, in such dividends.

2B. Voting Rights. Except as otherwise provided by law or this Charter, the holders of Common Stock shall have equal voting rights on the basis of one vote per share.

2C. Issuance. Shares of Common Stock may be issued from time to time as the Board shall determine and on such terms and for such consideration as may be fixed by the Board.

Section 3. Preemptive Rights. No holder of shares of the Corporation of any class now or hereafter authorized shall, as such holder, have any preferential or preemptive right to subscribe for, purchase or receive any shares of the Corporation of any class, now or hereafter authorizing, or any options or warrants for such shares, or any rights to subscribe to or purchase such shares or any securities convertible into or exchangeable for such shares, which may at any time be issued, sold or offered for sale by the Corporation. The Board shall have the right to issue the authorized and treasury shares of the Corporation at such time and upon such terms and conditions and for such consideration as the Board shall determine.

## ARTICLE VII

### Commencement of Business

The Corporation will not commence business until consideration of an amount not less than $1,000.00 has been received for the issuance of shares.

## ARTICLE VIII

### Shareholders

Any action required or permitted to be taken by the shareholders of the Corporation must be effected at a duly called annual or special meeting of such holders and may not be effected by any consent in writing by such holders.

## ARTICLE IX

### Directors

The number of directors and the removal of directors shall be determined as follows:

Section 1. Number of Directors. The affairs of this Corporation shall be managed by a Board of up to eighteen (18) directors.

Effective as of the annual meeting of shareholders in 1997, the Board shall be divided into three classes, designated as Class I, Class II, and Class III, as nearly equal in number as possible. The initial term of office of Class I shall expire at the annual meeting of shareholders in 1998, that of Class II shall expire at the annual meeting in 1999, and that of Class III shall expire at the annual meeting in 2000, and in all cases as to each director until his or her successor shall be elected and shall qualify, or until his or her earlier resignation, removal from office, death, or incapacity.

Subject to the foregoing, at each annual meeting of shareholders the successors to the class of directors whose term shall then expire shall be elected to hold office for a term expiring at the third succeeding annual meeting and until their successors shall be elected and qualified. Vacancies on the Board, for any reason, and newly created directorships resulting from any increase in the authorized number of directors may be filled by a vote of the majority of the directors then in office, although less than a quorum, or by a sole remaining director.

If the number of directors is changed, the Board shall determine the class or classes to which the increased or decreased number of directors shall be apportioned; provided that the directors in each class shall be as nearly equal in number as possible. No decrease in the number of directors shall have the effect of shortening the term of any incumbent director.

Notwithstanding any other provisions of this Charter or the Bylaws of the Corporation (and notwithstanding that a lesser percentage may be specified by law, this Charter, or the Bylaws of the Corporation), the affirmative vote of the holders of 80% or more of the voting power of the shares of the then outstanding Voting Stock, voting together as a single class, shall be required to amend or repeal, or adopt any provisions inconsistent with, this Article IX, Section 1 of this Charter.

Section 2. Removal of Directors. Directors may be removed by shareholders only for cause as defined in the Tennessee General Corporation Act.

## ARTICLE X

### Repurchase of Shares

The holders of shares shall have the right to approve the repurchase of the Corporation's shares by the Corporation from certain Interested Shareholders as follows:

Section 1. Vote of Shareholders Required for Certain Repurchases of Shares. The affirmative vote or consent of the holders or not less than a majority of the non−interested outstanding shares (as hereinafter defined) of stock of the Corporation entitled to vote in elections of directors (the "Voting Stock"), voting for the purposes of this Article X as one class, shall be required to approve any direct or indirect purchase by the Corporation of any shares of stock at a purchase price known by the Corporation to be above the Fair Market Value (as hereinafter defined and as determined on the date on which any such purchase by the Corporation occurs or is to occur) of such stock from a person who is known by the Corporation to be an Interested Shareholder (as hereinafter defined), unless such purchase is made by the Corporation pursuant to:

(a) a tender offer or exchange offer by the Corporation for some or all of the outstanding shares of such stock made on the same terms to all holders of such shares, or

(b) an open market purchase program approved by a majority of the Continuing Directors.

Section 2. Certain Definitions. For purposes of this Article X:

2A. A "person" shall mean any individual, firm, corporation or other entity.

2B. An "Interested Shareholder" shall mean any person (other than the Corporation or any Subsidiary) who or which:

(i) is the beneficial owner, directly or indirectly, of more than 5% of the voting power of the outstanding Voting Stock; or

(ii) is an Affiliate of the Corporation and at any time within the two−year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of 5% or more of the voting power of the then outstanding Voting Stock; or

(iii) is an assignee of or has otherwise succeeded to any shares of Voting Stock which were at any time within the two−year period immediately prior to the date in question beneficially owned by any interested Shareholder, if such assignment or succession shall have occurred in the course of a transaction or series of transactions not involving a public offering within the meaning of the Securities Act of 1933.

For the purposes of determining whether a person is an Interested Shareholder pursuant to paragraph 2B of this Section 2, the number of shares of Voting Stock deemed to be outstanding shall include shares deemed owned through application of paragraph 2C of this

Section 2, but shall not include any other shares of Voting Stock which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

2C. A person shall be a “beneficial owner” of any Voting Stock:

(i) which such person or any of its Affiliates or Associates (as hereinafter defined) beneficially owns, directly or indirectly; or

(ii) which such person or any of its Affiliates or Associates has (a) the right to acquire (whether such right is exercisable immediately or only after the passage of time), pursuant to any agreement, arrangement or understanding or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise, or (b) the right to vote pursuant to any agreement, arrangement or understanding; or

(iii) which are beneficially owned, directly or indirectly, by any other person with which such person or any of its Affiliates or Associates has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of any shares of Voting Stock.

2D. “Affiliate” or “Associate” shall have the respective meanings ascribed to such terms in Rule 12b−2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as in effect on June 1, 1985.

2E. “Subsidiary” means any corporation of which a majority of any class of equity security is owned, directly or indirectly, by the Corporation; provided, however, that for the purposes of the definition of an Interested Shareholder set forth in paragraph 2B of this Section 2, the term “Subsidiary” shall mean only a corporation of which a majority of each class of equity security is owned, directly or indirectly, by the Corporation.

2F. “Continuing Director” means any member of the Board who is unaffiliated with the Interested Shareholder and was a member of the Board prior to the time that the Interested Shareholder became an Interested Shareholder, and any successor of a Continuing Director who is unaffiliated with the Interested Shareholder and is recommended to succeed a Continuing Director by a majority of Continuing Directors who are then members of the Board.

2G. “Non−interested outstanding shares” are the shares of the Corporation entitled to vote in elections of directors (other than any shares beneficially owned by a person who is an Interested Shareholder) which are issued and outstanding on the record date for the determination of shareholders entitled to notice of, and to vote at, any meeting of shareholders.

2H. “Fair Market Value” shall mean the last sale price, on the last trading day immediately preceding the date upon which the purchase of a share of the Corporation’s stock by the Corporation occurs or is to occur, as such last sale price may be reported by the National Association of Securities Dealers, Inc. Automated Quotations National Market System or any system then in use, or if such stock is listed on a National Securities Exchange, the highest closing sale price on the day in question, of a share of such stock on such exchange, or if no such quotations are available, the fair market value on the day in question of a share of such stock as determined by the Board in good faith.

Section 3. No Effect on Fiduciary Obligations of Interested Shareholders. Nothing contained in this Article X shall be construed to relieve any Interested Shareholder from any fiduciary obligation imposed by law.

Section 4. Determinations by the Board. The Board shall have the power and duty to determine, for purposes of this Article X, on the basis of information known to such Board after reasonable inquiry:

(a) the number of shares of stock of the Corporation beneficially owned by any person;

(b) whether a person is an Interested Shareholder;

(c) the number of non−interested outstanding shares on the record date for any shareholders’ meeting;

(d) whether a person is an Affiliate or Associate of another;

(e) whether Section 1 of this Article X is or has become applicable with respect to a proposed purchase of shares by the Corporation; and

(f) if so, the Fair Market Value of such shares and whether the purchase price thereof is above such Fair Market Value.

Any such determination made in good faith shall be conclusive and binding for all purposes of this Article X. For the purposes of determining whether a person is an Interested Shareholder and determining the number of non−interested outstanding shares, the number of shares of stock of the Corporation deemed to be outstanding and entitled to vote in elections of Directors shall include shares deemed beneficially owned by such Interested Shareholder through application of clauses (i), (ii) or (iii) of paragraph 2B of Section 2 of this Article X but shall not include any other shares which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

Section 5. Amendment, Repeal, Etc. The provisions of this Article X may not be amended, modified or repealed unless authorized and approved by the affirmative vote of the holders of not less than a majority of the non−interested outstanding shares of stock of the Corporation entitled to vote in elections of directors, voting as one class.

## ARTICLE XI

### Indemnification

The Corporation shall have the authority and right to indemnify and hold harmless its officers, directors, employees, and agents from and against any claim, liability, loss, or expense (including attorney's fees) with respect to which such indemnification is permitted under the applicable provisions of the Tennessee General Corporation Act, the Bylaws of the Corporation, or any duly adopted resolution of the Board or shareholders; provided, however, that absent any limitation or modification set forth in the Bylaws or any resolution, this Article XI shall require the Corporation to indemnify and hold harmless its officers, directors, employees and agents to the fullest extent permitted under the applicable provisions of the Tennessee General Corporation Act. Such right of indemnification shall not be deemed exclusive of any other rights to which such director, officer or employee may be entitled apart from this provision.

## ARTICLE XII

### Bylaws

The Board shall have power to make, alter, amend and repeal the Bylaws (except so far as the Bylaws adopted by the shareholders shall otherwise provide). Any Bylaws made by the directors under the powers conferred hereby may be altered, amended or repealed by the Board or by the shareholders.

## ARTICLE XIII

### Special Meeting of Shareholders

No special meeting of shareholders shall be held upon the demand of shareholders of the Corporation unless the holders of at least twenty−five percent (25%) of all the votes entitled to be cast on each issue proposed to be considered at the special meeting shall have signed, dated, and delivered to the Corporation's Secretary one or more written demands for the meeting describing the purpose of purposes for which it is to be held.

# Saks Incorporated

## *2000 Change of Control and Material Transaction Severance Plan*

Amended and Restated as of August 31, 2006

### 1. General

**A**. **Purpose**. The Saks Incorporated Change of Control and Material Transaction Severance Plan (this "***Plan***") protects a designated group of associates against some of the financial consequences of several adverse events affecting employment so as to attract and retain the associates and motivate them to enhance the value of the underlying businesses of Saks Incorporated (the "C***ompany***") and its subsidiaries. This Plan is intended to qualify as an unfunded welfare plan under Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended.

**B. Effective Date of this Plan**. The effective date of this Plan is August 31, 2006 (the "***Effective Date***").

### 2. Eligibility and Participation

**A. Eligibility**. Subject to the next sentence and the exclusions contained on Schedules 1(a) and 1(b), each associate of the Company or a subsidiary of the Company (each an "***Employer***") who is either (i) in a position of employment listed on Schedule 1(a) or 1(b) to this Plan on or after the Effective Date or (ii) designated by the Company's Employee Benefits Committee (each person referred to in either (i) or (ii), a "***Designated Associate***"), shall become a participant in this Plan. If the Designated Associate has rights to severance compensation from the Designated Associate's Employer pursuant to a written agreement, the Designated Associate shall not be a participant in this Plan unless and until the Designated Associate waives all of the Designated Associate's rights to severance compensation pursuant to the written agreement in form and substance satisfactory to the Employee Benefits Committee in its sole discretion. Each Designated Associate who becomes a participant in this Plan in accordance with this subsection A. is a "***Participant***" except as otherwise provided in this Plan. All store managers, all associates reporting directly or indirectly to store managers, and all store−based division associates are excluded from participating in the Plan and none of them is a Participant. The Company's Employee Benefits Committee and its successors with comparable functions are referred to in this Plan as the "***Committee***".

**B. Notice of Participation**. The Company shall notify Participants in writing of their participation in this Plan, give each Participant a copy of this Plan upon Participant's request, and otherwise comply with the requirements of ERISA.

**C. Termination of Participation**. A Participant's participation in this Plan shall automatically terminate, without notice to or consent of Participant, and after the termination of participation the Designated Associate shall not be treated as a Participant, upon the earliest to occur of the following events:

(i) the Designated Associate's death;

(ii) the Designated Associate suffers, on or before termination of employment with all Employers, a mental or physical condition that (a) prevents the Designated Associate from reasonably discharging the duties of the Designated Associate's position, and (b) is attested to in writing by a physician selected by the Employer and reasonably acceptable to the Designated Associate;

(iii) the Employer's termination of the Designated Associate's employment for any reason except as the result of, and within two years after, a Change of Control (defined in Section 7.B.) or a Reduction in Force (defined in Section 7.I.); and

(iv) the Designated Associate terminates the Designated Associate's own employment, except for Good Reason (defined in Section 7.G.) within two years after a Change of Control.

When the participation of a Designated Associate in this Plan terminates in accordance with this Section 2.C., the Designated Associate shall not be entitled to severance pay or other benefits under this Plan following termination of participation.

**D. Determination of Eligibility**. To the fullest extent permitted by law, a Participant's eligibility for severance pay and other benefits under this Plan shall be determined by the Committee in its sole discretion.

**3. Severance Benefits**

**A. Termination**. Subject to a Participant's termination of participation pursuant to Section 2.C. and the conditions set forth below, if:

(i) Participant's employment with the Employer is terminated by the Employer as the result of a Reduction in Force as to Participant;

(ii) subject to the last sentence of this subsection A. and to subsection B. of this section, Participant's employment with the Employer is terminated by the Employer as the result of, and within two years after, a Change of Control; or

(iii) Participant terminates Participant's own employment with the Employer for Good Reason within two years after a Change of Control;

then Participant shall be entitled to severance pay and other benefits under this Plan in the amounts provided in Sections 3.C. and 3.D. of this Plan. For the avoidance of doubt, Participant shall be entitled to severance pay in accordance with clause (ii) of this subsection A only if the Employer's termination of Participant's employment is without Cause and is the direct result of, and within two years after, a Change of Control, and termination after a Change of Control for reasons of Participant's inadequate job performance shall not entitle the Participant to severance pay.

**B. Limitations.**

(1) A transfer of a Participant's position of employment or an offer to transfer from one Employer (the "***Original Position***") to a position of employment with another Employer or to an affiliate of either shall not constitute a termination of employment for purposes of subsection A.(ii) of this Section if the new position of employment (i) includes at least the same annual base salary amount and at least the same annual base rate of bonus potential (determined as a percentage of annual base salary) as the Original Position's annual base salary amount and annual base rate of bonus potential (determined as a percentage of annual base salary), (ii) includes duties and responsibilities that are comparable to the Original Position's duties and responsibilities, and (iii) is located not more than fifty miles from the location of the Original Position.

(2) Neither a change in job title nor a change in volume of business managed shall constitute a termination of employment for purposes of subsection A.(ii) of this Section if the duties and responsibilities of the job (other than the volume of business managed) after the change are comparable in all material respects to the duties and responsibilities of the job prior to the change.

**C. Amount of Severance Pay.**

(i) The amount of severance pay to which a Participant is entitled in accordance with Section 3.A. shall be equal to the amount listed on Schedule 1(a) or 1(b), subject to the next sentences of this Section 3.C.(i). The increased severance benefit ("Enhanced Severance") provided in Schedule 1(b) is limited to Participant's who are employed as Saks Incorporated "Corporate" associates, and the opportunity to receive Enhanced Severance is subject to the terms, conditions and limitations specified in Schedule 1(b). Enhanced Severance is not available for Associates employed in the Saks Fifth Avenue Enterprises, Club Libby Lu or Parisian businesses or any individuals who are specifically and exclusively assigned to work in those businesses. "***Base Salary***" on Schedule 1(a) or 1(b) means Participant's weekly base salary in effect immediately prior to the termination of employment (but subject to the next sentence). Any reduction in weekly base salary that either (i) results in, occurs in connection with, or otherwise precedes a termination resulting from a Reduction in Force or a termination without Cause or (ii) constitutes Good Reason, shall be ignored for purposes of determining Base Salary.

(ii) If a Participant is employed in a position of employment by more than one Employer, Participant shall be entitled to only one severance payment in accordance with this Plan upon termination regardless of the number of employment positions terminated. Participants shall not be entitled to any other duplicative severance payment.

(iii) If a Participant's employment with the Employer is terminated by the Employer as a result of a Reduction in Force as to Participant and the termination occurs within two years after a Change of Control, Participant shall be entitled to only one severance payment in accordance with this Plan upon termination.

(iv) Participants are not required to mitigate their damages, and severance pay is not subject to mitigation.

(v) Except as required by Section 6.J and unless the Company or the Employer shall have acted in bad faith or engaged in intentional misconduct, no Employer shall be liable to a Participant for any damages with respect to this Plan exceeding the amount of severance pay to which Participant is entitled in accordance with this Plan.

(vi) The Employer may deduct and withhold from severance pay all amounts required to be deducted or withheld by law.

**D. Other Benefits**. If the Employer maintains a pension plan in which Participant is a participant, Participant shall be entitled to credited service, if available under and as limited by, the pension plan, as amended from time to time, for a period of time represented by the number of weeks of base salary payable to Participant in accordance with this Plan.

**E. Time of Payment**. All severance payments shall be paid, at the Employer's election, either in a lump sum or in substantially equal installments (without interest). Lump sum payments shall be made, and installments shall begin, not later than 15 days following Participant's termination of employment.

**4. Claims**

**A. Claims Procedure**. If any Participant has a claim for benefits under this Plan that are not being paid, Participant may file with the Secretary of the Committee a written claim setting forth the amount and nature of the claim, supporting facts, and Participant's address. The Chairman of the Committee shall designate an individual to review the claim (the "***Authorized Representative***"). The Authorized Representative shall notify Participant of the Authorized Representative's decision in writing by registered or certified mail within 60 days after the Authorized Representative's receipt of the claim or, under special circumstances, within 120 days after its receipt of the claim. If the claim is denied, the written notice of denial shall list the reasons for denial, refer to pertinent Plan provisions on which the denial is based, describe any additional material or information necessary for Participant to realize the claim, and explain the claim review procedure under this Plan.

**B. Claims Review Procedure**. If the Authorized Representative denies a Participant's claim, Participant may file a written request for review of the denial by the Committee. The Committee shall review the claim and notify Participant in writing of its decision within 30 days after receipt of the request. In special circumstances, the Committee may extend for up to 30 additional days the deadline for its decision. The notice of the final decision of the Committee shall include the reasons for its decision and specific references to the provisions of this Plan on which the decision is based. The decision of the Committee shall be final and binding on all parties.

**C. ERISA Rights.**

(i) Participants may obtain copies of all Plan information upon written request to the Plan Administrator. The Plan Administrator and others who operate this Plan must do so prudently and in the interest of Participants. No Employer or other person may fire or otherwise unlawfully discriminate against a Participant in any way to prevent Participant from obtaining a severance benefit or exercising his or her rights under ERISA. If discrimination occurs, Participant may seek assistance from the U.S. Department of Labor or may file suit in a federal court.

(ii) A Participant is entitled to receive a written explanation of the reasons for the denial of Participant's claim, and to have the Committee review and reconsider the claim. Participant may file suit in a state or federal court to challenge any claim denial.

(iii) Under ERISA, there are steps a Participant can take to enforce the above rights. For instance, if materials are requested from this Plan and are not received within 30 days, Participant may file suit in a federal court. In that event, the court may require the Plan Administrator to provide the materials and pay Participant up to $100 a day until the materials are received, unless due to reasons beyond the control of the Plan Administrator. The court will decide who should pay court costs and legal fees. The court may order either Participant or the person sued by Participant to pay legal costs and fees. Contact the Plan Administrator for answers to questions. If a Participant has any questions about this Section 4.C. or about rights under ERISA, contact the nearest Area Office of the U.S. Labor−Management Services Administration, Department of Labor.

**D. Agent for Service of Legal Process**. Service of legal process upon this Plan shall be made upon the Plan Administrator at the address indicated in Section 5.B. of this Plan.

**5. Administration**

**A. Plan Sponsor**. The Company is Plan Sponsor for this Plan and an Employer participating in this Plan. The Company's address is 750 Lakeshore Parkway, Birmingham, Alabama 35211.

**B. Plan Administrator**. The Company shall administer this Plan through the Committee. The address of the Plan Administrator is:

Employee Benefits Committee

750 Lakeshore Parkway

Birmingham, Alabama 35211

Attn: Secretary

**C. Quorum**. A majority of the members of the Committee shall constitute a quorum for any meeting held concerning this Plan. The act of a majority of the members of Committee, whether at a meeting or approved in writing without a meeting, shall be the valid act of the Committee.

**D. Duties**. The Committee shall have the power and duty to do all things necessary or convenient to effect the intent and purposes of this Plan, whether or not the powers and duties are specifically described in this Plan including without limitation the power to:

(i) provide rules for the management, operation, and administration of this Plan and, from time to time, amend or supplement the rules;

(ii) construe this Plan in the Committee's sole discretion to the fullest extent permitted by law, which shall be final and conclusive upon all persons; and

(iii) correct any defect, supply any omission, or reconcile any inconsistency in this Plan in a manner and to the extent as the Committee shall deem appropriate in its sole discretion to carry this Plan into effect.

**E. Binding Authority**. The decisions of the Committee and its duly authorized delegate within the powers conferred by this Plan shall be final and conclusive for all purposes of this Plan, and shall not be subject to any appeal or review other than pursuant to Section 4.

**F. Exculpation**. No member of the Committee shall be directly or indirectly responsible or otherwise liable by reason of any action or default as a member of the Committee or of the exercise of or failure to exercise any power or discretion as the member, except for any action, default, exercise or failure to exercise resulting from the member's gross negligence or willful misconduct. No member of the Committee shall be liable in any way for the acts or defaults of any other member of the Committee or any of its advisors, agents, or representatives.

**G. Indemnification**. The Company shall indemnify and hold harmless each member of the Committee against any and all expenses and liabilities arising out of the member's membership on the Committee, except for expenses and liabilities arising out of the member's gross negligence or willful misconduct.

**H. Compensation**. Members of the Committee who are employees of the Company shall not receive any compensation for their services rendered as members.

**I. Information**. The Company may furnish to the Committee in writing all information the Committee requires to exercise its powers and duties in the administration of this Plan. The information may include, without limitation, the names of all Participants, their earnings and their dates of birth, employment, retirement or death. The information shall be conclusive for all purposes of this Plan, and the Committee shall be entitled to rely on the information without investigation.

**J. Self Interest**. No member of the Committee may act, vote, or otherwise influence a decision of the Committee specifically relating to the member's benefits, if any, under this Plan.

**6. General Provisions**

**A. Non−Property Interest**. This Plan is unfunded. Any liability of an Employer to any person with respect to benefits payable under this Plan shall give rise only to a claim as an unsecured creditor against the general assets of the Employer. Any Participant who may have or claim any interest in or right to any compensation, payment, or benefit payable under this Plan shall rely solely upon the unsecured promise of Participant's Employer for payment. Nothing in this Plan shall give to or vest in Participant or any other person, now or at any time in the future, any right, title, interest, or claim in or to any specific asset, fund, reserve, account, insurance, annuity policy, or contract, or other property of any kind whatsoever owned by the Employer, or in which the Employer may have any right, title, or interest now or at any time in the future.

**B. Other Rights**. Subject to the next sentences of this subsection B., this Plan supersedes (1) the Carson Pirie Scott & Co. 1994 Executive Severance Plan as amended and restated, effective as of April 3, 1998, the Younkers, Inc. Change In Control Severance Plan, and the Saks Holdings, Inc. Executive Severance Policy (each a "***Superseded Plan***"), which plans and policy are terminated and of no force or effect from and after the effective date of this Plan, and (2) all other plans, policies, and programs providing severance pay benefits for the Designated Associates (together, the "***Existing Programs***"), under which Existing Programs the Designated Associates shall have no rights to receive severance pay benefits from and after the effective date of this Plan (the terms of the Existing Programs to the contrary notwithstanding). If a Participant has vested rights under a Superseded Plan or one of more of the Existing Programs on the effective date of this Plan, (i) those vested rights shall continue until they terminate in accordance with the terms of the Superseded Plan or Existing Program and (ii) unless and until such vested rights terminate in accordance with the terms of the applicable Superseded Plan or Existing Program, Participant shall have no rights, and neither the Company nor any Employer shall have any obligation to Participant, of any kind under this Plan, including without limitation pursuant to Section 2 of this Plan. This Plan shall not affect or impair the rights or obligations of an Employer or a Participant (other than with respect to severance pay benefits) under any other contract, arrangement, or pension, profit sharing, or other compensation plan.

**C. Amendment or Termination**. (i) This Plan (including Schedules 1(a) and 1(b), may be amended, suspended, or terminated by the Committee in its sole discretion, subject to the approval of the Chief Executive Officer of the Company and subject to subsections (ii) and (iii).

(ii) If this Plan is amended, suspended, or terminated after a Participant's employment is terminated by the Employer as a result of a Reduction in Force, Participant's rights under this Plan to receive the severance pay and other benefits under this Plan shall continue in full force and effect as if the amendment, suspension, or termination had not occurred.

(iii) If this Plan is amended, suspended, or terminated within two years after a Change of Control, Participant's rights under this Plan to receive the severance pay and other benefits under this Plan if (a) Participant's employment is terminated without Cause within two years after the Change of Control or (b) Participant terminates Participant's own employment for Good Reason within two years after the Change of Control, in each case shall continue in full force and effect as if the amendment, suspension, or termination had not occurred.

(iv) If the Company ceases to own, directly or through subsidiaries, at least 50.1% of outstanding voting stock or at least 50.1% of the outstanding equity interests of an Employer, then, subject to the next sentences, (a) the Employer shall cease to be an Employer for purposes of this Plan (an "***Employer Termination***"), and (b) the participation in this Plan of all Participants that are employed by such Employer shall automatically terminate, without notice to or consent of the Participants. If an Employer Termination occurs after a Participant's employment is terminated by the Employer as a result of a Reduction in Force, Participant's rights under this Plan to receive the severance pay and other benefits under this Plan shall continue in full force and effect as if the Employer Termination had not occurred. If an Employer Termination occurs within two years after a Change of Control, Participant's rights under this Plan to receive the severance pay and other benefits under this Plan if (a) Participant's employment is terminated without Cause within two years after the Change of Control or (b) Participant terminates Participant's own employment for Good Reason within two years after the Change of Control, in each case shall continue in full force and effect as if the Employer Termination had not occurred.

**D. Severability**. If any term or condition of this Plan shall be invalid or unenforceable to any extent or in any application, then the remainder of this Plan, with the exception of the invalid or unenforceable provision, shall not be affected and shall continue in effect and application to its fullest extent. If, however, the Committee determines in its sole discretion that any term or condition of this Plan which is invalid or unenforceable is material to the interests of the Company, the Committee may, subject to subsection C. of this section, declare this Plan null and void in its entirety.

**E. No Employment Rights**. Neither the establishment of this Plan, any provisions of this Plan, nor any action of the Committee shall be held or construed to confer upon any employee the right to a continuation of employment by Participant's Employer. Subject to any applicable employment agreement, each Employer reserves the right to dismiss any employee, or otherwise deal with any employee, to the same extent as though this Plan had not been adopted.

**F. Incapacity**. If the Committee determines that a Participant receiving payment of benefits under the Plan is unable to care for Participant's affairs because of illness or accident, any benefit due Participant may be paid to Participant's spouse or to any other person deemed by the Committee to have incurred expense for Participant (including a duly appointed guardian, committee, or other legal representative), and any payment shall be a complete discharge of the Employer's obligation under this Plan.

**G. Successors and Assigns; Transferability of Rights**. This Plan is binding upon the Company and each Employer and the successors (including without limitation by merger or otherwise by operation of law) and permitted assigns of each. Each Employer shall have the unrestricted right to transfer its obligations under this Plan with respect to one or more Participants to any person, including without limitation to any purchaser of all or any part of the Employer's business. The payment to a Participant of severance pay in the amount provided herein by the purchaser of all or any part of an Employer's business, or by any other person to whom an Employer has transferred its obligations hereunder, shall be in complete satisfaction of the Employer's obligation to pay severance pay hereunder to such Participant. No Participant or spouse of a Participant shall have any right to commute, encumber, transfer, or otherwise dispose of or alienate any present or future right or expectancy that Participant or the spouse may have at any time to receive payments of benefits under this Plan, which benefits and the right are expressly declared to be nonassignable and nontransferable, except to the extent required by law. Any attempt to transfer or assign a benefit, or any right granted under this Plan, by a Participant or the spouse of a Participant shall, in the sole discretion of the Committee (after consideration of the facts they deem pertinent), be grounds for terminating any rights of Participant or the spouse to any portion of this Plan benefits not previously paid.

**H. Entire Document**. This Plan, as amended from time to time, supersedes any and all prior understandings, agreements, descriptions, and arrangements regarding the subject matter of this Plan, except for written employment or severance agreements executed and delivered by an Employer.

**I. Governing Law**. This Plan shall be construed, administered, and enforced according to the laws of the State of Alabama, except to the extent those laws are preempted by the federal laws of the United States of America.

**J. Enforcement**. If a Participant brings any litigation to enforce Participant's rights under this Plan, the Company shall reimburse Participant for reasonable attorney's fees and disbursements incurred in the litigation if (i) Participant obtains a final court order awarding Participant damages in an amount equal to 50% or more of the damages Participant demanded in the litigation, or (ii) Participant and the Company or Participant's Employer agree in writing to a settlement in which the Company or the Employer agrees to pay Participant an amount equal to 50% or more of the damages Participant demanded in the litigation.

## 7. Definitions

**A. "*Cause*"** means any act or any failure to act on the part of Participant which constitutes:

(i) Participant's conviction, after all applicable rights of appeal have been exhausted or waived, for any crime that materially discredits the Company or the Participant's

Employer or is materially detrimental to the reputation or goodwill of the Company or the Participant's Employer;

(ii) commission of any material act of fraud or dishonesty by Participant against the Company or Participant's Employer or commission of an immoral or unethical act that materially reflects negatively on the Company or Participant's Employer, but only if Participant shall first be provided by the Company or Participant's Employer with written notice of the alleged immoral or unethical act and then shall have the opportunity to contest the alleged immoral or unethical act before the chief executive officer of the Company;

(iii) Participant's willful and continual material breach of the material terms and conditions of Participant's employment with Participant's Employer; or

(iv) Participant's willful violation of any policy of Participant's Employer that in accordance with the Employer's customary practices results in discharge after the first occurrence.

No act or failure to act by a Participant will be deemed "willful" unless it is done, or omitted to be done, by Participant in bad faith or without reasonable belief that the action or omission was in the best interests of the Company or Participant's Employer.

**B. "*Change of Control*"** means the happening of any one or more of the following:

(1) Any person or entity, including a "group" as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended, other than Company, a subsidiary of the Company, or any employee benefit plan of the Company or its subsidiaries, becomes the beneficial owner of the Company's securities having 25 percent or more of the combined voting power of the then outstanding securities of the Company that may be cast for the election for directors of the Company (other than as a result of an issuance of securities initiated by the Company in the ordinary course of business); or

(2) As the result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions, less than a majority of the combined voting power of the then−outstanding securities of the Company or any successor corporation or entity (excluding any subsidiary or former subsidiary of the Company) entitled to vote generally in the election of directors of the Company or such other corporation or entity after such transaction, are held in the aggregate by holders of the Company's securities entitled to vote generally in the election of directors of the Company immediately prior to such transactions; or

(3) During any period of two consecutive years, individuals who at the beginning of any such period constitute the Board of Directors of the Company cease for any reason to constitute at least a majority thereof, unless the election, or the nomination for election by the Company's stockholders, of each director of the Company first elected during such period

was approved by a vote of at least two−thirds of the directors of the Company then still in office who were directors of the Company at the beginning of any such period.

**C. "*Committee*"** is defined in Section 2.A.

**D. "*Company*"** is defined in Section 1.A.

**E.** "***Designated Associate***" is defined in Section 2.A.

**F. "*Employer*"** is defined in Section 2.A.

**G. "*Good Reason*"** means Participant's (a) annual base salary amount or annual base rate of bonus potential (determined as a percentage of annual base salary) is reduced or (b) location of employment with the Employer is changed by the Employer to a location that is more than fifty miles from the location of Participant's employment with the Employer on the day first preceding a Change of Control.

**H. "*Participant*"** is defined in Section 2.A.

**I. "*Reduction in Force*"** means (1) the termination of Participant's employment with the Participant's Employer due to the elimination of Participant's position or job function (each an "***Eliminated Position***") that occurs as a result of or in connection with the sale or other transfer for consideration to an acquiror that is not an affiliate of the Company of any material asset or assets (considered alone or together if a series of related transactions) of the Company or any Employer, excluding each transaction referred to above in this sentence that also constitutes a Change of Control, and (2) Participant is not offered another position of employment (to begin immediately following the elimination of the Eliminated Position) by the Employer, the acquiror, or any affiliate of either, that includes each of the following:

(i) at least the same amount of annual base salary and at least the same annual base rate of bonus potential (determined as a percentage of annual base salary) as the Eliminated Position's amount of annual base salary and annual base rate of bonus potential (determined as a percentage of annual base salary); and

(ii) is located not more than fifty miles from the Eliminated Position's location.

Saks Incorporated,

By: /s/ Paul D. Shore
Paul D. Shore
Senior Vice President of Human Resources

**Schedule 1(a)**

**SEVERANCE BENEFITS**

| **Position of Employment (Group of Designated Executives)** | **Severance Payment in Accordance with Section 3.C (Weeks of Base Salary)** |
|---|---|
| Division Presidents and Corporate Executive Vice Presidents and Corporate Senior Vice Presidents | 104 weeks |
| Division Executive Vice Presidents and Division Senior Vice Presidents | 78 weeks |
| Corporate Vice Presidents and Division DMMs | 52 weeks |
| Director−level associates and Buyers | 26 weeks, unless qualified for Enhanced Severance in Schedule 1(b) below. |
| All other exempt and non−exempt associates not employed in Stores | Severance based on length of service with the Company as follows (unless qualified for Enhanced Severance in Schedule 1(b) below):<br><br>0−6 months of service: 2 weeks<br><br>7−12 months of service: 4 weeks<br><br>>12 months of service: a minimum of 12 weeks, or one week for each year of service, whichever is greater, but not more than 52 weeks (for greater than 12 months service, a partial year of service is credited as a whole year) |

**Severance benefits pursuant to Section 3.C.(i) of this Plan and described above in this Schedule 1(a) are subject to the following terms, conditions and limitations:**

1) Associates must remain in their position until released from employment by the Company,

2) Associates must not have been transferred to or received an offer of comparable employment (as defined in Section 3.B. of this Plan) within Saks Incorporated or any acquiring company, and

3) Associates must continue to perform their duties in a satisfactory manner and comply with the Company's policies and procedures in effect from time to time.

4) The Company's determinations as to who is eligible for the enhanced benefits in Schedule 1(a) described above, how much Enhanced Severance is payable in any situation, and all related matters are final and binding.

5) An associate is entitled to benefits under either Schedule 1(a) or 1(b), but not both.

**Schedule 1(b)**

**ENHANCED SEVERANCE BENEFITS**

**(Replaces Schedule 1(a) for Saks Incorporated "Corporate" associates in certain positions designated in this Schedule 1(b) and eligibility for Enhance Severance is subject to the terms, conditions and limitations noted below)**

| **Position of Employment (Group of Designated Executives)** | **Severance Payment in Accordance with Section 3.C (Weeks of Base Salary)** |
|---|---|
| Division Presidents and Corporate Executive Vice Presidents and Corporate Senior Vice Presidents | Not eligible |
| Division Executive Vice Presidents and Division Senior Vice Presidents | Not eligible |
| Corporate Vice Presidents and Division DMMs | Not eligible |
| Director−level associates and Buyers | 52 weeks (see conditions and limitations below) |
| All other exempt and non−exempt associates not employed in Stores | Severance based on length of service with the Company as follows (see conditions and limitations below):<br>• 0−6 months of service: 4 weeks<br>• 7−12 months of service: 8 weeks<br>• Greater than 12 months service – minimum 24 weeks, or 2 weeks per year of service, up to a maximum of 52 weeks (for greater than 12 months service, a partial year of service is credited as a whole year) |

**Enhanced Severance pursuant to Section 3.C.(i) and described above in this Schedule 1(b) are subject to the following terms, conditions and limitations:**

1) Associates must remain in their position until released from employment by the Company,

2) Associates must not have been transferred to or received an offer of comparable employment (as defined in Section 3.B. of this Plan) within Saks Incorporated or any acquiring company, and

3) Associates must continue to perform their duties in a satisfactory manner and comply with the Company's policies and procedures in effect from time to time.

4) Associates who participate in any Company retention pay program are not eligible for benefits under Schedule 1(b).

5) Enhanced Benefits in accordance with Schedule 1(b) are provided to those associates employed in positions for Saks Incorporated Corporate, Saks Support Group, and Saks Distribution Center in Steele, Alabama except the following:

- associates who are part of the Northern Department Store Group sale,
- corporate−based Alterations associates,
- associates in Department Store Group Corporate Central,
- Corporate Loss Prevention associates based in the Steele, Alabama facility,
- Accounting associates based in the Aberdeen, Maryland facility,
- Distribution, Fulfillment and International Services associates in the Aberdeen, Maryland facility,
- Asset Protection associates in the Aberdeen, Maryland facility, and
- all associates employed in Saks Fifth Avenue Enterprises, Club Libby Lu or Parisian businesses or any individuals who are specifically and exclusively assigned to work at Saks Fifth Avenue Enterprises, Club Libby Lu or Parisian.

6) The Company's determinations as to who is eligible for the enhanced benefits in Schedule 1(b) described above, how much enhanced severance is payable in any situation and all related matters are final and binding.

7) An associate is entitled to benefits under either Schedule 1(a) or 1(b), but not both.

# Stock Option Agreement

***__________, 20__***

This is a Stock Option Agreement between Saks Incorporated (the "***Company***") and the individual who has executed this Stock Option Agreement above the signature line "Signature of Optionee") (the "***Optionee***").

## Preliminary Statement

This Agreement is made pursuant to the Company's 2004 Long−Term Incentive Plan (the "***Plan***"). Capitalized terms used but not defined in this Agreement are defined in the Plan as of, and without giving effect to any amendment after, the date of this Agreement.

## Terms and Conditions

The Company and the Optionee agree as follows:

**1. *Options Covered.***

a. This Agreement is an agreement referred to in paragraph 6 of the Plan. For each of the Company's stock option grants to the Optionee pursuant to the Plan (each an "***Option Grant***"), this Agreement, the Plan, and each document given to the Optionee reflecting the amount, exercisability, and other terms of the Option Grant ("***Grant Document***") govern. Each Grant Document is incorporated by reference into, and made a part of, this Agreement. In this Agreement the words (i) "***Common Stock***" mean the Company's Common Stock, par value $.10 per share, (ii) "***Option***" and "***Options***" mean the right and option to purchase all or any part of the number of shares of Common Stock subject to an Option Grant, (iii) "***exercise of the Options***" and similar words used in this Agreement mean the purchase of shares of Common Stock subject to an Option Grant in accordance with this Agreement, (iv) "***Exercise Price***" mean the price the Optionee must pay to the Company to exercise an option as specified by the Company in a Grant Document. The Optionee is not required to exercise the Options. The Options are not "incentive stock options" as those terms are used in Section 422 of the Internal Revenue Code of 1986.

b. No Option may be exercised after the date that is the seventh anniversary of the Option's date of grant and will terminate on that date (the "***Option Termination Date***").

**2. *Exercisability of Options*.**

a. Except as the Grant Document may otherwise specify for an Option Grant and (i) subject to the other Sections of this Agreement and the Plan, and (ii) unless the Options have terminated or have been forfeited in accordance with this Agreement or the Plan, the Optionee on or before the Option Termination Date may purchase shares of Common Stock subject to an Option Grant as follows:

| ***Percent Of Number Of Shares Specified In The Option Grant That May Be Purchased*** | ***Date After Which Shares May Be Purchased*** |
|---|---|
| 25% | First anniversary of date of grant |
| 50% | Second anniversary of date of grant |
| 75% | Third anniversary of date of grant |
| 100% | Fourth anniversary of date of grant |

The above vesting schedule applies only if the Grant Document is silent as to vesting.

**3. *Exercising the Options.***

a. The Optionee may exercise Options that are exercisable in accordance with Section 2 and that have not terminated or been forfeited in accordance with this Agreement or the Plan. To exercise Options included as part of an Option Grant, the Optionee must, on or prior to the Option Termination Date for the Option Grant, notify the Company (attention: Senior Stock Plan Administrator) of the number of whole shares of Common Stock the Optionee intends to purchase. The Optionee may not purchase less than 100 shares of Common Stock upon any exercise unless the number of shares of Common Stock subject to the Options at the time of exercise is less than that number. Unless otherwise directed by the Company and subject to Section 10, the Optionee must include payment of the Exercise Price times the number of shares of Common Stock to be purchased (the "***Purchase Price***"). The date on which the Optionee delivers the written notice to the Company in accordance with this subsection a. is referred to in this Agreement as the "***Exercise Date.***" Any fraction of a share of Common Stock that would be required to pay the Purchase Price will be disregarded and the remaining amount due will be paid in cash by the Optionee.

b. The Optionee must pay the Purchase Price (1) in cash, (2) by delivery (either actual delivery or by attestation procedures established by the Company) of shares of Common Stock having an aggregate fair market value, determined as of the date of exercise, equal to the aggregate purchase price payable by reason of the exercise, (3) except as may be prohibited by applicable law, in cash by a broker−dealer acceptable to the Company to whom the Optionee has submitted an irrevocable notice of exercise, or (4) by combination of (1) and (2).

c. When the Optionee complies with the requirements of this Section 3 and is otherwise in compliance with this Agreement and the Plan, in each case to the reasonable satisfaction of the Committee, the Company will promptly deliver to the Optionee one or more stock certificates that together represent, or at the Company's election deliver to the Optionee other appropriate evidence of, the shares of Common Stock that the Optionee has purchased.

**4. *Termination of Employment*.**

a. Except as provided in this Section 4 and in Section 5, the Optionee may not exercise Options unless the Optionee is then in the employ of the Company or an affiliated corporation, and the Optionee has remained continuously so employed since the date of grant of the Options.

b. If the Optionee's employment terminates (other than by reason of disability, retirement from employment with the Company at age 65, or death), the Optionee may, for a period of three months from the date of termination, exercise all Options that are exercisable in accordance with Section 2 (determined in accordance with subsection d. of this Section 4) and that have not otherwise terminated or been forfeited in accordance with this Agreement or the Plan.

c. If the Optionee's employment terminates by reason of retirement from employment with the Company at age 65 or disability, the Optionee may, for a period of one year from the date of termination, exercise all Options that are exercisable in accordance with Section 2 (determined in accordance with subsection d. of this Section 4) and that have not otherwise terminated or been forfeited in accordance with this Agreement or the Plan.

d. For purposes of subsections b. and c. of this Section 4, the number of shares of Common Stock that may be purchased upon exercise of the Options in accordance with Section 2 will be determined as of the date of termination and not as of the date the Options are exercised or any other date.

e. Nothing in this Agreement or in the Plan will confer upon the Optionee any right to continue in the employ of the Company or any of its affiliated corporations or interfere in any way with the right of the Company or any affiliated corporation to terminate the Optionee's employment at any time.

**5. *Death of Optionee*.**

If the Optionee dies (a) while employed by the Company or an affiliated corporation , (b) within twelve months after termination due to retirement from employment with the Company at age 65 or disability, or (c) within three months after termination for any other reason, the Optionee's beneficiary may, for a period of one year from the date of the Optionee's death, exercise all Options that are exercisable in accordance with Section 2 (determined in accordance with the next sentence of this Section 5) and that have not otherwise terminated or been forfeited in accordance with this Agreement or the Plan. The number of shares of Common Stock that may be purchased upon exercise of the Options in accordance with Section 2 will be determined as of the date of death and not as of the date of termination or any other date.

**6. *Non−Transferability of Options*.**

Except as provided in the Plan, the Options are not transferable.

**7. *Rights as a Stockholder*.**

Neither the Optionee nor the permitted transferee of the Options will have any right as a stockholder with respect to the shares of Common Stock subject to the Options until the Company issues a stock certificate to the Optionee or the permitted transferee of the Options for the shares of

Common Stock acquired upon exercise of the Options in accordance with this Agreement. If the record date for any dividend or distribution precedes the Company's issuance of a stock certificate for shares of Common Stock acquired upon exercise of the Options in accordance with this Agreement, neither the Optionee nor the permitted transferee of the Options will be entitled to the dividend or distribution with respect to the shares of Common Stock represented by the stock certificate.

**8. *Forfeiture of Options*.**

(a) Notwithstanding anything in the Plan to the contrary and unless otherwise determined by the Committee, the Optionee will forfeit all unexercised Options if (i) the participant, without the written consent of the Company, engages directly or indirectly in any manner or capacity as principal, agent, partner, officer, director, employee or otherwise, in any business or activity determined by the Committee, in its sole discretion, to be competitive with any business or activity conducted by the Company or any of its subsidiaries; or (ii) the Optionee performs any act or engages in any activity that in the opinion of the Chief Executive Officer of the Company is inimical to the best interests of the Company.

(b) Notwithstanding anything in the Plan to the contrary and unless otherwise determined by the Committee, if within six months following an Optionee's termination of employment the Optionee, without the written consent of the Company, engages directly or indirectly in any manner or capacity as principal, agent, partner, officer, director, employee or otherwise in any business or activity determined by the Committee, in its sole discretion, to be competitive with any business or activity conducted by the Company or any of its subsidiaries, the participant shall be required to pay to the Company an amount in cash equal to the amounts realized in connection with the Optionee's exercise of Options on or after, or within six months prior to, the Optionee's termination of employment.

**9. *Other Restrictions*.**

The exercise of the Options is subject to the requirement that, if at any time the Committee determines that any one or more of the following is a reasonably necessary or desirable condition to exercise of the Options:

a. the listing, registration or qualification of the shares of Common Stock subject to the Options upon any securities exchange or in accordance with any applicable law,

b. the consent or approval of any regulatory or governmental authority, or

c. the Optionee's agreement to dispose of shares of Common Stock acquired pursuant to exercise of the Options in accordance with applicable law, then any exercise of the Options will not be effective until all of the conditions so determined by the Committee are met.

**10. *Taxes and Withholding*.**

a. The Optionee will pay to the Company, or make arrangements satisfactory to the Committee regarding payment of, all federal, state, and local income taxes required by law to be withheld upon the exercise of the Options ("***Taxes***"). The Company will, to the extent permitted or required by law, have the right to deduct all Taxes from any payment of any kind otherwise due to the Optionee.

b. The Optionee may satisfy the Optionee's obligation to pay Taxes by requesting that the Company withhold, from the shares of Common Stock to be delivered to the Optionee upon each exercise of the Options, a number of shares having a fair market value equal to the amount of the Taxes.

**11. *Effect of Agreement*.**

This Agreement will be binding upon and will inure to the benefit of any successor or successors of the Company.

**12. *Conflicts and Interpretation*.**

a. Except as provided in this Section 12, as to each Option Grant this Agreement, the Grant Document for the Option Grant, and the Plan constitute the entire agreement of the Company concerning the subject matter of this Agreement, the Grant Document, and the Plan.

b. The following rules of interpretation apply:

(i) If this Agreement and a Grant Document are silent about any matter, the Plan governs.

(ii) If a Grant Document conflicts with this Agreement, the Grant Document governs.

(iii) If a Grant Document conflicts with the Plan, the Plan governs.

(iv) If a Grant Document is silent about any matter and the Agreement conflicts with the Plan, the Plan governs.

(v) If a Grant Document is ambiguous, this Agreement governs unless this Agreement is ambiguous or silent, in which event the Plan governs.

(vi) The headings of sections are included solely for convenience of reference and will not affect the meaning or interpretation of this Agreement.

**13. *Notices*.**

Notices and communications under this Agreement must be in writing and delivered personally, by overnight courier, or by registered or certified United States mail, return receipt requested, postage prepaid. Notices to the Company must be addressed to:

Saks Incorporated

Human Resources Department

12 East 49th Street

New York, New York 10017

Attn: Senior Stock Plan Administrator

or any other address designated by the Company in a written notice to the Optionee. Notices to the Optionee will be directed to the address of the Optionee then currently on file with the Company, or at any other address given by the Optionee in a written notice to the Company.

**14. *Amendment*.**

This Agreement may not be modified, amended, or waived in any manner except in writing signed by the Company and the Optionee. The waiver by the Company or the Optionee of compliance with any provision of this Agreement will not operate or be construed as a waiver of any other provision of this Agreement, or of any subsequent breach of a provision of this Agreement.

**15. *Administration*.**

The authority to manage and control the operation and administration of this Agreement will be vested in the Committee. The Committee will have all powers with respect to this Agreement as it has with respect to the Plan. Any interpretation of the Agreement by the Committee and any decision made by it with respect to the Agreement is final and binding on all persons.

**16. *Governing Law*.**

Tennessee law will govern the interpretation, performance, and enforcement of this Agreement, except to the extent that Tennessee law may be superseded by any federal law.

**Saks Incorporated**

By:

Executive Vice President−Human Resources

**Name of Optionee**

**Signature of Optionee**

# SAKS INCORPORATED

## SUBSIDIARIES AS OF APRIL 1, 2007

| Name of Subsidiary | Jurisdiction Of Formation | Tradenames |
|---|---|---|
| Cafe SFA—Minneapolis, Inc. | California | Saks<br>Saks Fifth Avenue |
| Club Libby Lu, Inc. | Illinois | Club Libby Lu |
| CPSIS, Inc. | Illinois | |
| Fifth Floor Restaurant at SFA LLC | New York | Saks<br>Saks Fifth Avenue |
| Jackson Leasing, LLC | Mississippi | |
| Jackson Office Properties, Inc. | Delaware | |
| Merchandise Credit, LLC | Virginia | |
| New York City Saks, LLC | New York | Saks<br>Saks Fifth Avenue<br>Club Libby Lu<br>Off 5th Saks Fifth Avenue Outlet |
| Saks & Company | New York | Saks<br>Saks Fifth Avenue<br>Club Libby Lu<br>Off 5th Saks Fifth Avenue Outlet |
| Saks Direct, Inc. | New York | Saks<br>Saks Fifth Avenue<br>Saks.com<br>Saksfifthavenue.com |
| Saks Fifth Avenue Distribution Company | Delaware | Saks<br>Saks Fifth Avenue |
| Saks Fifth Avenue Food Corporation | California | Saks<br>Saks Fifth Avenue |
| Saks Fifth Avenue, Inc. | Massachusetts | Saks<br>Saks Fifth Avenue<br>Club Libby Lu<br>Off 5th Saks Fifth Avenue Outlet |
| Saks Fifth Avenue of Texas, Inc. | Delaware | |
| Saks Fifth Avenue Texas, L.P. | Delaware | Saks<br>Saks Fifth Avenue<br>Club Libby Lu<br>Off 5th Saks Fifth Avenue Outlet |
| Saks Holdings, Inc. | Delaware | |
| SCCA, LLC | Virginia | Saks |

| | | |
|---|---|---|
| | | Saks Fifth Avenue<br>Club Libby Lu<br>Off 5th Saks Fifth Avenue Outlet |
| SCCA Store Holdings, Inc. | Delaware | |
| SCIL, LLC | Virginia | Saks<br>Saks Fifth Avenue<br>Off 5th Saks Fifth Avenue Outlet |
| SCIL Store Holdings, Inc. | Delaware | |
| Second Floor Restaurant at SFA LLC | New York | Saks<br>Saks Fifth Avenue |
| SFA Holdings, Inc. | Delaware | |
| SFA Realty, Inc. | Delaware | |
| SFAILA, LLC | Virginia | Saks<br>Saks Fifth Avenue |
| Sixth Floor Restaurant at SFA LLC | New York | Saks<br>Saks Fifth Avenue |
| Tex SFA, Inc. | New York | |
| The Restaurant at Saks Fifth Avenue Corporation | New York | Saks<br>Saks Fifth Avenue |

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements listed below of Saks Incorporated of our report dated April 2, 2007 relating to the financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in the Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10−K. We also consent to the incorporation by reference of our report dated April 2, 2007 relating to the financial statement schedules, which appears in this Form 10−K.

Registration Statements on Form S−3

Registration Numbers

333−55805

333−61881

333−64175

333−66755

333−71933

333−116578

Registration Statements on Form S−4

Registration Numbers

333−09043

333−41563

333−60123

333−75120

333−113239

Registration Statements on Form S−8

Registration Numbers

33−88390

333−00695

333−25213

333−47535

333−51244

333−66759

333−83161

333−83159

333−91416

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Birmingham, Alabama

April 2, 2007

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statement on Form S−8 (File No. 333−91416) of Saks Incorporated and Subsidiaries of our report dated April 2, 2007 relating to the financial statements of Saks Incorporated Employee Stock Purchase Plan, which appears in Exhibit 99.1 in this Form 10−K.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Birmingham, AL

April 2, 2007

Pursuant to the certification requirements of Section 302 of the Sarbanes−Oxley Act of 2002, the principal executive officer of the registrant has complied as follows.

I, Stephen I. Sadove, certify that:

1. I have reviewed this annual report on Form 10−K of Saks Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a−15(e) and 15d−15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a−15(f) and 15d−15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls or procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 2, 2007

/s/ Stephen I. Sadove
Stephen I. Sadove
Chief Executive Officer

Pursuant to the certification requirements of Section 302 of the Sarbanes−Oxley Act of 2002, the principal financial officer of the registrant has complied as follows.

I, Kevin G. Wills, certify that:

1. I have reviewed this annual report on Form 10−K of Saks Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a−15(e) and 15d−15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a−15(f) and 15d−15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls or procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 2, 2007

/s/ Kevin G. Wills
Kevin G. Wills
Executive Vice President of Finance and

Chief Accounting Officer

## CERTIFICATION OF CHIEF EXECUTIVE OFFICER

**Pursuant to Section 906 of the Sarbanes−Oxley Act of 2002 (18 U.S.C. 1350)**

The undersigned, Stephen I. Sadove, has executed this certification in connection with the filing with the Securities and Exchange Commission of Saks Incorporated’s (the “Company”) Annual Report on Form 10−K for the fiscal year ended February 3, 2007 (the “Report”).

The undersigned hereby certifies that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company

IN WITNESS WHEREOF, the undersigned has executed this certification as of the 2nd day of April, 2007.

/s/ Stephen I. Sadove
Stephen I. Sadove
Chief Executive Officer

**CERTIFICATION OF CHIEF ACCOUNTING OFFICER**

**Pursuant to Section 906 of the Sarbanes−Oxley Act of 2002 (18 U.S.C. 1350)**

The undersigned, Kevin G. Wills, has executed this certification in connection with the filing with the Securities and Exchange Commission of Saks Incorporated's (the "Company") Annual Report on Form 10−K for the fiscal year ended February 3, 2007 (the "Report").

The undersigned hereby certifies that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company

IN WITNESS WHEREOF, the undersigned has executed this certification as of the 2nd day of April, 2007.

/s/ Kevin G. Wills
Kevin G. Wills
Executive Vice President of Finance and

Chief Accounting Officer

# Saks Incorporated Employee Stock Purchase Plan

## Financial Statements

## December 31, 2006 and 2005

**Saks Incorporated Employee Stock Purchase Plan**

**Index**

**December 31, 2006 and 2005**

PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers LLP**

1901 6th Ave. North

Suite 1600

Birmingham AL 35203

Telephone (205) 252 8400

Facsimile (205) 252 7776

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors of Saks Incorporated

In our opinion, the accompanying statements of net assets available for benefits and the related statements of changes in net assets available for benefits, present fairly, in all material respects, the net assets available for benefits of Saks Incorporated Employee Stock Purchase Plan (the "Plan") at December 31, 2006 and 2005, and the related changes in net assets available for benefits for the three years ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Plan's management; our responsibility is to express an opinion on these statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Birmingham, Alabama

March 28, 2007

**Saks Incorporated Employee Stock Purchase Plan**

**Statements of Net Assets Available for Benefits**

**December 31, 2006 and 2005**

| | 2006 | 2005 |
|---|---|---|
| **Assets** | | |
| Cash held by Saks Incorporated | $— | $— |
| **Liabilities** | | |
| Due to participants | $— | $— |
| Due to terminated employees | — | — |
| Net assets available for benefits | $— | $— |

The accompanying notes are an integral part of these financial statements.

**Saks Incorporated Employee Stock Purchase Plan**

**Statements of Changes in Net Assets Available for Benefits**

**Years Ended December 31, 2006, 2005 and 2004**

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| **Additions** | | | |
| Participant contributions | $ 718,753 | $ 689,637 | $ 976,028 |
| **Deductions** | | | |
| Purchase of common stock | 575,656 | 653,043 | 976,028 |
| Return of contributions to terminated employees | 143,097 | 36,594 | — |
| Net change | — | — | — |
| **Net assets available for benefits** | | | |
| Beginning of year | — | — | — |
| End of year | $ — | $ — | $ — |

The accompanying notes are an integral part of these financial statements.

## 1. Summary of Significant Accounting Policies and Description of the Plan

The following description of the Saks Incorporated Employee Stock Purchase Plan (the "Plan") is provided for general information only. Participants should refer to the Plan agreement for a more complete description of the Plan's provisions.

### General

The Plan provides employees of Saks Incorporated and Subsidiaries (the "Company") an opportunity to purchase shares of common stock of the Company at a 15% discount to market value. The Plan is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code of 1986, as amended, and is therefore not subject to federal and state income taxes.

The Board of Directors authorized, and the Shareholders approved an aggregate of 1,450,000 shares available for purchase under the Plan. The number of shares of common stock to be issued under the Plan and the period for which the option to purchase shares will remain outstanding (the "Option Period") are based on an annual determination by the Compensation Committee of the Company's Board of Directors. Option periods currently end on December 31 of each year. The price at which the stock may be purchased is 85% of the lesser of the closing price per share as listed on the New York Stock Exchange on the last business day preceding (i) the grant of the option, or (ii) the exercise of the option. The Plan purchased 40,171 shares at an option price of $14.33 and 52,964 shares at an option price of $12.33 and 79,159 shares at an option price of $12.33 for the years ended December 31, 2006, 2005 and 2004, respectively. Currently, the Plan has 294,975 shares available for future offerings.

### Eligibility

Any employee of the Company who works at least 20 hours a week for the Company and has been employed by the Company for at least one year is eligible to participate in the Plan.

### Contributions

Eligible employees may elect annually to make after−tax contributions to the Plan through payroll deductions. Contributions are subject to limitations to be set annually by the Compensation Committee of the Company's Board of Directors. Each participant's account is credited with the participant's contributions. Participants are fully vested in their contributions. The contribution limitation was $2,400 for the years ended December 31, 2006 and 2005.

### Distribution of Stock

As soon as practicable after the purchase of stock by the Plan for its participants, the Company will deliver to each participant certificates representing the shares purchased on their account.

### Administrative Expenses

The Company pays for all administrative expenses of the Plan.

### Income Taxes

Participants are not taxed upon receipt or exercise of options, but rather upon disposition of shares purchased under the Plan.

### Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting.

**2. Plan Termination**

Although it has not expressed any intent to do so, the Company has the right under the Plan document to alter, suspend, amend or terminate the Plan. In the event of plan termination, the participants' rights to acquire stock would continue until the end of the current Option Period, at which time shares and cash due to terminated employees would be distributed and no further contributions would be accepted.

**3. Income Tax Status**

The Plan is designed to meet the requirements of the applicable sections of the Internal Revenue Code (IRC) and to, therefore, be exempt from federal income taxes under Section 501(a) of the IRC. Therefore, no provision for income taxes has been included in the Plan's financial statements.